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Capital Markets Union: a welcome start

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SUMMARY

The Commission's proposals for a Capital Markets Union are a welcome and necessary step in promoting a sustainable economic recovery across the EU. In particular, they provide an opportunity to create a properly-functioning Single Market in capital by diversifying funding and improving investment opportunities across the EU. The proposals aim to spread and mitigate risk throughout the financial system, while at the same time tackling problematic regulatory and administrative barriers and the deep-rooted cultural obstacles to growth that have held back economic recovery in the EU.

We support the Commission's proposed approach, including a mix of short-, medium- and long-term measures and a range of legislative and non-legislative tools. We particularly welcome the commitment to ensuring that Capital Markets Union is for all 28 Member States. The Commission's Green Paper is a helpful starting point for these discussions, although the sheer quantity of proposals it sets out creates a danger of a lack of focus. A good starting point is to identify those measures that are most necessary to support the Commission's jobs and growth agenda.

To that end, we welcome the publication of a consultation on reviewing the Prospectus Directive. A careful balance must be struck between easing the burden on issuers (an entity that sells new securities to raise funds), particularly SMEs, and ensuring that consumer protection is not weakened. Indeed principles of consumer and investor protection should underpin all aspects of Capital Markets Union.

While securitisation markets suffered considerable damage during the financial crisis, they have a key role to play in managing and transferring risk in the financial system. We therefore welcome the Commission's consultation on developing a framework for high quality securitisation, which will build on the attempts of the European Central Bank, the Bank of England and the European Banking Authority to revive the subdued EU securitisation market. Yet considerable obstacles remain.

We also welcome the Commission's emphasis on promoting and developing the private placement market and on enhancing the availability of credit information on SMEs. The growth of peer-to-peer lending and crowdfunding (raising of capital in small increments from large numbers of people for a specific purpose) has considerable potential to increase access to finance. Yet further work is needed if this market is to develop across borders.

There is also a need for realism. Capital markets cannot and should not replace the banking sector, but should rather complement it as an alternative source of funding. The state of development of capital markets varies considerably between Member States, and the needs, cultures and priorities for Member States without developed markets will differ significantly from those such as the UK.

Different tax treatments of financial instruments across Member States could impede the development of pan-European capital markets. The lack of harmonisation of securities law and insolvency law is another potential barrier. Yet agreement on reform of these areas will be difficult to secure. Any proposal for a system of pan-EU supervision is likely to be equally contentious.

The Commission's focus is on enhancing access to finance for SMEs. Yet the term 'SMEs' covers an extremely broad range of companies, and not all will benefit from Capital Markets Union. The onus is on companies themselves to take advantage of the opportunities that will be created.

The EU has much to learn from the development of US capital markets as a source of funding, and it is important to ensure that Capital Markets Union contributes to, rather than conflicts with, the development of consistent international standards.

Nevertheless, Capital Markets Union presents a significant opportunity for the UK to promote the importance of capital markets, benefiting not just the UK economy but the EU as a whole. The UK must ensure that it is at the forefront of the debate as the Capital Markets Union agenda takes shape in the coming months.

LIST OF CONCLUSIONS AND RECOMMENDATIONS

Capital Markets Union in context

1. The Commission's proposals for Capital Markets Union are a welcome and necessary step in promoting a sustainable economic recovery across the EU. In addition to being a further move towards completion of the Single Market by seeking to remove obstacles to a properly functioning Single Market in capital, they provide, in particular, an opportunity to:

    - Diversify funding and investment opportunities across the EU, creating a better match between borrowers and investors;
    - Reduce the overreliance on bank funding, in particular for SMEs;
    - Spread and mitigate risk throughout the financial system by contributing to the absorption of future asymmetric shocks, thereby reducing the vulnerability of the EU economy;
    - Tackle the deep-rooted cultural obstacles to growth that have held economic recovery in the EU back in comparison with international competitors. (Paragraph 12)

2. We welcome the Commission's proposed approach to Capital Markets Union, comprising: consultation with a wide range of experts and practitioners; recognition that an effective Capital Markets Union is a long-term goal; proposing a mix of short-, medium- and long-term measures; and setting out a range of legislative and non-legislative tools. We particularly welcome the commitment to ensure that Capital Markets Union is for all 28 Member States. The challenge for the Commission will be to ensure that these principles are adhered to in the months ahead. (Paragraph 14)

3. Where new legislative tools are needed, we stress, as we did in our recent report on *The post-crisis EU financial regulatory framework*, that effective Impact Assessments need to be carried out, including a full cost-benefit analysis. Given our concerns that compliance costs have been underestimated in the past, the Commission must take full account of the predicted and actual costs of future regulatory measures. (Paragraph 15)

The components of Capital Markets Union

4. We welcome the Commission's publication of a consultation on reviewing the Prospectus Directive, and its efforts to introduce a more streamlined and effective regime. It is important to seek to ease the burden on issuers, particularly SMEs, and to increase consistency of approach to liability and sanctions across Member States. We support measures that will encourage issuers to take full advantage of existing passporting opportunities. At the same time, it is essential that consumer protection is not weakened. Otherwise there will be insufficient demand for any new financial instruments that may be devised and the project will not succeed. A careful balance must be struck to ensure that markets are attractive both for issuers and investors. (Paragraph 25)

5. Securitisation markets suffered considerable reputational damage during the financial crisis, and the EU markets have remain subdued. Yet they have a key role to play in managing and transferring risk in the financial system, lowering the costs of funding and thereby restoring growth and jobs. We support the work already undertaken by the European Central Bank, the Bank of England and the European Banking Authority to revive the EU securitisation market. We also welcome the priority placed by the Commission on building a high quality securitisation market. We caution, however, that there are obstacles to achieving greater standardisation and transparency for SME securitisations, thanks to intrinsic information asymmetries. (Paragraph 30)

6. We welcome the Commission's emphasis on promoting and developing the private placement market. We hope that the market-led approach advocated by the Commission proves successful. Member States must also play an active part in promoting investment-friendly environments for these markets to flourish. (Paragraph 34)

7. The idiosyncratic and diverse nature of SMEs means that it is more difficult and proportionately more expensive to make a credit assessment of them. It will be difficult to shift the pattern of SMEs' reliance on bank financing, given the comparative advantages that banks have in assessing SMEs and the strong relationships that often exist between them. It is important to ensure that a bank's expertise in assessing and lending to SMEs should not be lost. Nevertheless, we welcome the Commission's efforts to widen the investor base for SMEs, given the problems that they have faced in attracting finance since the crisis erupted. The Commission's proposals to enhance the availability of credit information by developing a minimum set of comparable standards and promoting credit scoring are helpful steps, which would enable investors better to compare and assess SMEs. We look forward to further concrete steps being brought forward as a result of the workshops on SME credit information that the Commission plans to hold in 2015. (Paragraph 39)

8. The growth of online alternative financing platforms such as peer-to-peer lending and crowdfunding has considerable potential to increase access to finance for early stage and fast growing companies. Yet the growth of cross-border activity is hampered by the varying approaches of Member States. We encourage the Commission to undertake further analysis to determine adequate and appropriate measures at a national and European level to allow these markets to grow and develop across borders. It is important that these markets continue to provide support to early stage businesses, while ensuring an adequate level of protection for funders. (Paragraph 42)

9. Different tax treatment across Member States and between various types of financing could impede the development of genuinely pan-European capital markets. We note in particular the tax bias in favour of debt over equity. Nevertheless, the requirement for unanimity in EU taxation measures means that agreement on reform is difficult to secure. While we support the Commission in its efforts to encourage greater consistency in tax treatment, this should not become a distraction from its attempts to bring about more easily achievable reforms. (Paragraph 45)

10. We welcome the identification of investor protection as a key principle of Capital Markets Union, and support proposals to ensure that investors and savers have improved access to investment information and advice. We also welcome efforts to explore how new tools such as guidance can aid consumers and investors in dealing with investment products. It is important, while protecting investors, not to overburden them with information. It equally must be recognised that financial advisers and fund disclosure managers all require a high level of disclosure in order to fulfil their functions and responsibilities, which are so important for investors. (Paragraph 56)

11. We welcome the Commission's commitment to amend existing regulations so as to encourage infrastructure investment, making it more cost-effective for funds to be set up and marketed across the EU. We call on the Commission to consider how European Long-Term Investment Funds might be encouraged to operate effectively across borders, accessing a wide range of investors in the EU and beyond. (Paragraph 61)

12. We reiterate our support for the creation of a simple, transparent and sustainable high quality securitisation market that enjoys investor confidence. To that end, we support moves to create greater transparency, to enable investors to evaluate risks within and across products. (Paragraph 66)

13. The lack of harmonisation of legal approaches to such issues as securities law and insolvency law is a potential barrier to an effective Capital Markets Union. We welcome the Commission's efforts to encourage Member States to introduce minimum standards, for instance in relation to insolvency. Nevertheless, full harmonisation of legal systems remains a distant prospect, and we urge the Commission to prioritise the politically possible. (Paragraph 70)

Pitfalls, obstacles and opportunities

14. Our recent report on *The post-crisis EU financial regulatory framework* made the case for strengthening the powers, role and resources of the three European Supervisory Authorities. We also recognise the principled case for as much consistency across all 28 Member States as possible. There may well be a role for ESMA to play in overseeing specific aspects of Capital Markets Union. Yet a distinction must be drawn between consistent application of a common rulebook and direct supervision of capital markets at the EU level. Any attempt to establish a system of pan-EU supervision would not only be contentious, but could prove an unhelpful distraction from the necessary reforms that Capital Markets Union is seeking to bring about. (Paragraph 75)

15. The term 'SMEs' covers an extremely broad range of companies, varying not only in size but in their ambition and motivation to grow. Capital Markets Union is unlikely to benefit all such companies. Nevertheless, many will be well-placed to make use of the avenues for access to financial investment that Capital Markets Union could create. We urge the Commission to consider how those SMEs who want to take advantage of Capital Markets Union can be encouraged to do so. Yet ultimately, the onus lies on SMEs themselves to respond. (Paragraph 80)

16. The EU has much to learn from the development of US capital markets as a source of funding. The Commission should look to US models such as the

Small Business Administration, to see if similar programmes can be adopted, whether at EU or Member State level. The EU must also ensure that Capital Markets Union contributes to, rather than conflicts with, the development of consistent international standards. In that light, we stress the importance of international co-operation and co-ordination, not only with the US but with other, growing, global markets. A failure to include financial services regulatory matters in the Transatlantic Trade and Investment Partnership (TTIP) would be a missed opportunity. (Paragraph 85)

17. Amid the positive reaction to Capital Markets Union, it is important to retain a sense of perspective. Significant obstacles remain. Capital markets cannot, and should not, replace the banking sector, but rather should complement it as an alternative source of funding for economic growth. It is important that the financial sector is treated as an integrated whole, rather than as a set of silos. The state of development of capital markets varies considerably between Member States, and the needs, cultures and priorities for Member States without developed markets will differ significantly from those such as the UK, where capital markets are relatively well developed. (Paragraph 90)

18. We welcome the short-term initiatives that the Commission has identified. We also recognise that there are longer-term, more contentious issues that will need to be tackled if a true Capital Markets Union is to be created. Yet the sheer quantity of proposals that the Commission has set out in its Green Paper creates a danger that Capital Markets Union could lack focus. A good starting point would be to identify those measures that are most necessary to support the EU's jobs and growth agenda. (Paragraph 91)

19. Capital Markets Union presents a significant opportunity for the UK positively to promote the importance of capital markets, benefiting not just the UK economy, but the EU as a whole. We encourage the Government and the UK financial sector to do all they can to share best practice with other Member States, while recognising that the UK can itself learn from others. The UK must ensure that it is at the forefront of the debate as the Capital Markets Union agenda takes shape in the coming months. (Paragraph 94)

20. It will not suffice simply to react to others' proposals: the City and the Government should be active in responding to the Commission's initiative. (Paragraph 95)

21. We welcome the Commission's proposals for Capital Markets Union, as a vital means of unlocking investment and providing finance for SMEs, with the potential to boost economic growth in the EU as a whole. At the same time, we make the following observations:

    - As it takes its proposals forward, the Commission must balance the need, on the one hand, to ensure that companies have sufficient access to capital and investment opportunities, and are not overburdened by onerous requirements with, on the other, adequate protection for consumers and investors.

    - The Commission must also ensure that Capital Markets Union remains focused on jobs and growth.

- The Commission is right to propose a balance of short-, medium- and long-term measures, and legislative and non-legislative proposals, but must take care that Capital Markets Union does not lose focus through the sheer number of ideas on offer.
- The Commission must also ensure that all its proposals are subject to a rigorous Impact Assessment and cost-benefit analysis.
- A differentiated approach must be taken, reflecting the specific characteristics of each element of the EU's capital markets. At the same time, capital markets should not be treated in isolation, but rather as an integral set of transactions and relationships within the wider financial system. (Paragraph 96)

22. Capital Markets Union presents an opportunity to break down obstacles to the creation of a properly-functioning Single Market in capital. We will scrutinise the Commission's proposals closely as they take shape in the coming months. Our initial assessment of this timely initiative is positive. (Paragraph 97)

Capital Markets Union: a welcome start

CHAPTER 1: CAPITAL MARKETS UNION IN CONTEXT

This report

1. In his opening statement to the European Parliament Plenary on 15 July 2014, Jean-Claude Juncker, the then Candidate for President of the European Commission, announced that: "to improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and help reduce our very high dependence on bank funding. This would also increase the attractiveness of Europe as a place to invest."[1]

2. Following his appointment, President Juncker tasked the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, with "bringing about a well-regulated and integrated Capital Markets Union, encompassing all Member States, by 2019, with a view to maximising the benefits of capital markets and non-bank financial institutions for the real economy."[2]

3. On 18 February 2015, the European Commission published a Green Paper on *Building a Capital Markets Union*.[3] The Green Paper states that capital markets in the EU remain fragmented and have retreated inside national borders. It observes that they are relatively underdeveloped compared with other jurisdictions and play a less significant role in financing the economy. As businesses remain heavily reliant on bank funding they are vulnerable to a tightening of lending in the event of a crisis.

4. The Green Paper sets out the challenges in European capital markets today, priorities for early action, measures to develop and integrate capital markets, and next steps. Alongside the Green Paper, the Commission published two consultation documents on the Prospectus Directive[4] and on *An EU framework for simple, transparent and standardised securitisation*.[5] The Commission invites responses to all three documents by 13 May 2015. The Commission states that it will organise a conference in the summer of 2015

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1 Jean-Claude Juncker, Candidate for President of the European Commission, *A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change* (15 July 2014): http://ec.europa.eu/priorities/docs/pg_en.pdf [accessed 5 March 2015]

2 Jean-Claude Juncker, President of the European Commission, *Mission Letter to Jonathan Hill, Commissioner for Financial Stability, Financial Services and Capital Markets* Union (1 November 2014): http://ec.europa.eu/archives/juncker-commission/docs/hill_en.pdf [accessed 5 March 2015]

3 European Commission Green Paper, *Building a Capital Markets Union*, COM (2015) 63 FINAL

4 European Commission Consultation Document, *Review of the Prospectus Directive* (18 February 2015): http://ec.europa.eu/finance/consultations/2015/prospectus-directive/docs/consultation-document_en.pdf [accessed 5 March 2015]

5 European Commission Consultation Document, *An EU framework for simple, transparent and standardised securitisation* (18 February 2015): http://ec.europa.eu/finance/consultations/2015/securitisation/docs/consultation-document_en.pdf [accessed 5 March 2015]

to draw the consultation to a close. An Action Plan on Capital Markets Union will then be published later in 2015, with a view to putting in place "the building blocks for a fully functioning Capital Markets Union by 2019."[6]

5. This report sets out the Committee's views on Capital Markets Union, and forms the Committee's formal response to the Commission Green Paper and consultation documents. It is informed by an evidence session held on 3 February 2015 with Lord Hill of Oareford. We are grateful to Lord Hill for agreeing to appear before the Committee and for the insight he provided on the thinking behind the Commission's proposals. In addition, on 10 February 2015 we held a seminar with various experts and practitioners in the field. A note of that seminar is included in Appendix 3.[7]

6. We will continue to scrutinise Capital Markets Union as the Commission's proposals take shape in the coming months. In the meantime, **we make this report to the House for debate.**

Why is Capital Markets Union necessary?

7. Lord Hill told us that Capital Markets Union was a key component of the Commission's jobs and growth agenda:

> "Put at its most simple, the purpose of Capital Markets Union is to make it easier to link savings to growth and to channel savings from anywhere in the EU to be invested in businesses anywhere in the EU. The goal is a true Single Market in capital."[8]

8. Lord Hill also stressed that a key element of Capital Markets Union was to improve SME access to funding. Although there was no single solution to the problem, an accumulation of measures to promote alternative sources of funding would help.[9] Lord Hill said that there was "a strong wind of support" among Member States for Capital Markets Union, because it was recognised that the over-dependence on bank financing was a stumbling block to economic recovery and led to an over-concentration of risk in the financial system.[10]

9. Our seminar participants broadly supported Lord Hill's view. Hugo Dixon, columnist and commentator at Thomson Reuters, said that the constraints that banks were operating under meant that alternative sources of financing were urgently needed. While it could not eliminate risk, Capital Markets Union would spread risk more widely, meaning the effects of a shock to the financial system would be less concentrated. Phil Evans, Director (International), Bank of England, stressed three benefits: a better match of borrowers and investors (known as "allocative efficiency"); combating the overreliance on bank funding; and enhancing risk-sharing across the EU.

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6 COM (2015) 63 FINAL

7 Unless stated otherwise, all subsequent citations are drawn from the note of the seminar in Appendix 3.

8 Q 1

9 QQ 7–8

10 Q 9

10. David Doyle, EU financial services expert, The Genesis Initiative, said that Capital Markets Union was necessary because the EU economy remained sluggish eight years after the financial crisis erupted, with 11.4% unemployment and a record number of small business collapses. Barnabas Reynolds, Partner, Shearman and Sterling, said that EU markets were held back by a lack of harmonisation. In his view, Capital Markets Union presented an opportunity to create a liberalised and pan-EU approach.

11. Some participants stressed the deep-rooted cultural impediments to fully functioning capital markets. Charles Roxburgh, Director-General, Financial Services, HM Treasury, said that the home market bias and the cultural resistance of entrepreneurs to give up control by floating companies elsewhere were significant obstacles. David Doyle referred to entrenched cultural norms, which meant that retail investors in shares and bonds retreated behind their national frontiers. Savings tended to be compartmentalised within Member States and it was difficult to provide insurance coverage across borders. He said that some 94% of European citizens shied away from buying a foreign financial product. Hugo Dixon said that vested interests in Member States needed to be swept away. Sharon Bowles, former Chair of the European Parliament Economic and Monetary Affairs (ECON) Committee, cited the different cultural attitudes to business failure. Whereas involvement in a 'tried and failed' business was viewed in a positive light in the US, in the UK, for instance, there would be a reluctance to include it on one's CV. Jonathan Faull, Director-General for Financial Stability, Financial Services and Capital Markets Union, European Commission, said that the constraints of cultural and legal traditions in Member States needed to be tackled if Capital Markets Union was to be a success.

12. **The Commission's proposals for Capital Markets Union are a welcome and necessary step in promoting a sustainable economic recovery across the EU. In addition to being a further move towards completion of the Single Market by seeking to remove obstacles to a properly functioning Single Market in capital, they provide, in particular, an opportunity to:**

- **Diversify funding and investment opportunities across the EU, creating a better match between borrowers and investors;**
- **Reduce the overreliance on bank funding, in particular for SMEs;**
- **Spread and mitigate risk throughout the financial system by contributing to the absorption of future asymmetric shocks, thereby reducing the vulnerability of the EU economy;**
- **Tackle the deep-rooted cultural obstacles to growth that have held economic recovery in the EU back in comparison with international competitors.**

The Commission's approach

13. Lord Hill identified five principles underpinning the Commission's approach. He stressed that it was:

- "A bottom-up exercise, not a top-down one". Lord Hill said that he wanted to hear from investors, market participants, consumer groups, the City of London, national parliaments and anyone else with an interest, so as to "understand from people who know the marketplace day to day better than I do what they think the consequences of a particular measure might be, and any suggestions they have for making things work better."[11]

- A long-term, incremental programme. Lord Hill told us that "for me to claim that I can flick a switch so that we can do this in a simple, straightforward way in a couple of years' time would not be a realistic way to think about it … there is no single reason, no single lever that I can pull, no silver bullet, but there will be a lot of detailed, unglamorous work to carry out proper analysis and then to try to come up with solutions."[12]

- A combination of urgent prioritisation of more easily achievable reforms with a longer-term approach to more contentious issues.[13] Lord Hill said that part of the rationale for this was because of the urgency of the jobs and sustainable growth agenda: "If one takes the most difficult and contentious issues all in one go right at the beginning, we will still be debating it in two or three years' time. We will be more than half way through the mandate. Meanwhile, I will not have got the concrete steps that might make things better."[14]

- A project for the whole of the EU. Lord Hill told us that "this is an extremely important point: it is a Single Market for all 28 Member States."[15] Several seminar participants drew the distinction between Capital Markets Union and Banking Union, which is a project for the eurozone (and other Member States wishing to participate). A key element of this distinction was that Capital Markets Union should include the UK—an issue we explore further in Chapter 3. Sharon Bowles welcomed the fact that any notion of a eurozone-only Capital Markets Union had been swept away. Jonathan Faull said that there was a need to be alert to 'banana skins' such as the temptation to take proposals forward among a smaller group of Member States.

- A mix of legislative and non-legislative proposals. Lord Hill said that it was not his intention to unleash "another wave of legislative proposals", but rather "to legislate where I need to legislate, and when we can do it without legislation, I will be happy with that, too."[16] Jonathan Faull said that there would be a mix of regulation and deregulation, and of legislative and non-legislative tools: both Country-Specific Recommendations and promoting examples of best practice from across Member States could be used as tools of persuasion. Hugo Dixon agreed

11 QQ 1, 4–5
12 QQ 3–4
13 Q 4
14 Q 6
15 Q 1
16 Q 4

that there needed to be a mix of regulation and deregulation. Graham Bishop, Consultant on European Integration, welcomed the use of Country-Specific Recommendations as a means to 'name and shame' recalcitrant Member States. Sharon Bowles agreed that Capital Markets Union should not involve another wave of legislation, but while she welcomed such tools as Country-Specific Recommendations, she was sceptical as to how effective they would be in practice.

14. **We welcome the Commission's proposed approach to Capital Markets Union, comprising: consultation with a wide range of experts and practitioners; recognition that an effective Capital Markets Union is a long-term goal; proposing a mix of short-, medium- and long-term measures; and setting out a range of legislative and non-legislative tools. We particularly welcome the commitment to ensure that Capital Markets Union is for all 28 Member States. The challenge for the Commission will be to ensure that these principles are adhered to in the months ahead.**

15. **Where new legislative tools are needed, we stress, as we did in our recent report on *The post-crisis EU financial regulatory framework*, that effective Impact Assessments need to be carried out, including a full cost-benefit analysis.[17] Given our concerns that compliance costs have been underestimated in the past, the Commission must take full account of the predicted and actual costs of future regulatory measures.**

[17] European Union Committee, *The post-crisis EU financial regulatory framework: do the pieces fit?* (5th Report, Session 2014–15, HL Paper 103)

CHAPTER 2: THE COMPONENTS OF CAPITAL MARKETS UNION

16. The Commission Green Paper sets out measures to improve access to finance for companies. There is a particular focus on SMEs, where innovative and high growth start-ups feature as a priority. The Commission also stresses the need to boost long-term financing, including infrastructure investment, and to boost institutional and retail investment, thereby promoting a variety of funding sources. The Commission identifies a number of short-term initiatives to improve the functioning of markets. These include reviewing the Prospectus Directive, developing sustainable securitisation, enhancing private placement markets, improving the availability of credit information, and making use of European Long-Term Investment Funds (ELTIFs).[18] We consider a number of these initiatives below, both from a corporate and investor perspective.

Improving and diversifying access to finance

17. Many witnesses explained that SMEs were a key target of a Capital Markets Union.[19] The Commission acknowledges that improving SMEs' access to finance would depend on overcoming information problems, reversing market fragmentation and lowering the cost of access to capital.[20] It sets out a number of proposals to achieve these reforms.

Prospectus Directive

18. The Prospectus Directive[21] governs the prospectus required of issuers[22] when they raise funds by means of a public offer of securities or through admitting their securities to a regulated market in the EU. The Directive is accordingly a cornerstone of EU capital markets regulation. It was last amended in 2010 and is due to be reviewed by January 2016.

19. Lord Hill said that it was important to review the Prospectus Directive to see if it was possible to reduce burdens on issuers, making it easier and more affordable to raise funds.[23] The consultation paper on reviewing the Prospectus Directive, published alongside the Green Paper, acknowledges its shortcomings. In particular it notes the lengthy, complex and expensive process of getting a prospectus approved by a National Competent Authority, and that practices at national level differ.[24]

20. David Doyle said that the Prospectus Directive needed radical change. It was complex, required too much information disclosure and was costly. There needed to be a common rulebook approach to simplifying the EU Prospectus rules. Lachlan Burn, Partner at Linklaters, and Barnabas Reynolds stressed

18 COM (2015) 63 FINAL

19 See Appendix 3: Charles Roxburgh, Barnabas Reynolds, David Doyle and Andrew Van der Lem.

20 COM (2015) 63 FINAL

21 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

22 An issuer is an entity that sells new securities to raise funds. See http://lexicon.ft.com/Term?term=issue.

23 Q 4

24 *Review of the Prospectus Directive*

the need to protect investors without creating an onerous regime that deterred issuers from entering the market.

21. Lachlan Burn added that the disclosure requirements in the Prospectus Directive should not be considered in isolation. Rather, they should be considered alongside other elements of the regulatory toolkit such as intermediation provisions in MiFID.[25] Jonathan Faull said that the need to achieve balance in terms of the information required of SMEs was a perennial dilemma, which meant that it had been difficult to get the Prospectus Directive exactly right.

22. Thomas Donegan, Partner at Shearman and Sterling, doubted that it was right to focus on the disclosure requirements of the Prospectus Directive. He argued that the current passport system, allowing the issuer to access investors elsewhere in the EU, was not widely used because of the translation obligations and concerns about liability. He said one solution would be to ease translation requirements, while another option could be to make passporting and translation mandatory. The exchange provider Bats Chi-X Europe explained that listing regimes remained nationally focused, while various obligations meant that companies were not incentivised to try to list on another exchange in a different Member State, missing out on a wider pool of investors. They called for pan-European exchanges to offer listings of SMEs and mid-caps, using a prospectus translated to a common denominator language such as English, to allow access to the broadest range of investors in Europe and globally. [26]

23. Sharon Bowles criticised the lack of coherence arising from different supervisory implementation practices across the EU. She pointed out that the UK implemented the toughest regime, and the UK would therefore need to support any lighter touch approach. Barnabas Reynolds highlighted that debt listings in Ireland and Luxembourg, for instance, gave rise to arbitrage issues. Although the European Securities and Markets Authority (ESMA) was meant to iron these issues out, it had not been able to do so.

24. David Lawton, Director of Markets, Financial Conduct Authority (FCA), stressed the importance of assessing whether some of the prospectus disclosure requirements could be streamlined, particularly for SMEs. The lack of harmonisation of liability regimes between Member States was a particular challenge.[27] Indeed the Commission consultation acknowledges that there might be a need to further harmonise liability and sanctions to create a level playing field in the EU.[28]

25. **We welcome the Commission's publication of a consultation on reviewing the Prospectus Directive, and its efforts to introduce a more streamlined and effective regime. It is important to seek to ease the burden on issuers, particularly SMEs, and to increase consistency of approach to liability and sanctions across Member States. We**

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25 Markets in Financial Instruments Directive

26 Bats Chi-X Europe, *A vision for the next five years: Making markets better to serve European citizens and companies*, 2014

27 Oral evidence taken on 28 October 2014 (Session 2014–15), Q 235

28 *Review of the Prospectus Directive*

support measures that will encourage issuers to take full advantage of existing passporting opportunities. At the same time, it is essential that consumer protection is not weakened. Otherwise there will be insufficient demand for any new financial instruments that may be devised and the project will not succeed. A careful balance must be struck to ensure that markets are attractive both for issuers and investors.

Developing securitisation as a source of funding

26. Securitisation is a process that pools assets owned by an originator (for example, a company or a lender) and repackages them into a tradable security. The security can then be bought by investors, who buy slices or 'tranches' of the credit risk relating to the exposures being securitised. The transformation is a tool for transferring risk and can be used for purposes of capital relief.[29]

27. The Green Paper prioritises the development of a sustainable high quality securitisation market in the EU.[30] The consultation on *An EU framework for simple, transparent and standardised securitisation*, published alongside the Green Paper, seeks views on specific measures to meet key objectives including ensuring high standards, legal certainty and comparability of instruments for investors, as well as transparency, consistency and availability of key information in relation to SME loans.[31]

28. Lord Hill said that the need to encourage safe, high-quality securitisation was one of his priorities for early action, noting that while the US market had recovered to pre-crisis levels, the EU market had yet to do so.[32] Sharon Bowles added that securitisation had not been too problematic in the EU but had nevertheless suffered from reputational damage because of the US subprime crisis. It has been reported that the European securitisation market has shrunk continuously in terms of issuance volume from €367 billion in 2009 to €156 billion in 2014, with barely half of that volume placed with investors. There has been a commensurate decline in the number of professionals and active market participants engaged in securitisation.[33]

29. Much progress has already been made in this area by the European Banking Authority (EBA), the Bank of England and the European Central Bank (ECB). In a 2014 joint strategy paper setting out how to restore the impaired EU securitisation market, the ECB and the Bank of England noted that securitisation could contribute to monetary policy and financial stability, especially when bank lending was being tightened.[34] Charles Roxburgh

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29 European Banking Authority, *EBA Discussion Paper on simple standard and transparent securitisations* (14 October 2014): https://www.eba.europa.eu/documents/10180/846157/EBA-DP-2014–02+Discussion+Paper+on+simple+standard+and+transparent+securitisations.pdf [accessed 5 March 2015]

30 COM (2015) 63 FINAL

31 *An EU framework for simple, transparent and standardised securitisation*

32 Q 4

33 Bank of America Merrill Lynch, *Saving the European asset-based finance markets*, 20 February 2015.

34 European Central Bank and Bank of England, *The impaired EU securitisation market: causes, roadblocks and how to deal with them* (2014): http://www.bankofengland.co.uk/publications/Documents/news/2014/paper070.pdf [accessed 5 March 2015]. See also *EBA Discussion Paper on simple standard and transparent securitisations*

stressed the benefits of freeing up bank balance sheets through securitisation of mid and large company assets, which would increase their lending capacity to small businesses. In addition, the Commission notes that it is already using securitisation vehicles to finance SMEs, in association with the European Investment Bank and the European Investment Fund.[35] Yet considerable obstacles to developing the SME securitisation market remain. Time is of the essence to restore a vibrant, healthy securitisation market in which all participants can have confidence. We discuss how securitisation pertains to investors in paragraph 62.

30. **Securitisation markets suffered considerable reputational damage during the financial crisis, and the EU markets have remain subdued. Yet they have a key role to play in managing and transferring risk in the financial system, lowering the costs of funding and thereby restoring growth and jobs. We support the work already undertaken by the European Central Bank, the Bank of England and the European Banking Authority to revive the EU securitisation market. We also welcome the priority placed by the Commission on building a high quality securitisation market. We caution, however, that there are obstacles to achieving greater standardisation and transparency for SME securitisations, thanks to intrinsic information asymmetries.**

Private placement market

31. Private placements are where a company makes an offering of securities to an individual or small group of investors not on public markets. They provide medium- to long-term financing for medium-sized, rated and unrated, listed and private companies, and can be a more cost-effective way for firms to raise funds. The private placement market also acts as a source of diversification for larger scale investors.[36]

32. The Green Paper states that barriers to the development of private placement markets include differences in national insolvency laws and a lack of standardised processes, documentation and information on the creditworthiness of issuers.[37] Lord Hill said that he wanted to encourage the private placement market, and that this was something he was looking to industry to take the lead on in the first instance, rather than looking to a legislative proposal.[38] The Pan-European Private Placement Working Group was set up in 2014 to establish a guide to best practice, facilitating the emergence of common market practice, principles and standardised documentation. The group also aims to identify barriers to entry into the market for new issuers and investors.[39] However, Sharon Bowles warned that an industry standard model would lack an effective enforcement mechanism if differences between Member States became a problem.

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35 *An EU framework for simple, transparent and standardised securitisation*

36 COM (2015) 63 FINAL

37 *Ibid*.

38 Q 4

39 International Capital Market Association, 'Trade bodies join forces to promote EU Private Placement market' (12 June 2014): http://www.icmagroup.org/assets/documents/Regulatory/Private-placements/Trade-bodies-join-forces-to-promote-EU-Private-Placement-market_ICMA14052014.pdf [accessed 5 March 2015]

33. Seminar participants made a comparison between the experience in the UK and other Member States. Charles Roxburgh noted that private placements were more developed in France and Germany, and that the UK was keen to import best practice from such countries. The Pan-European Private Placement Working Group welcomed the introduction in the UK of an exemption from withholding tax for interest on private placements.[40] The Investment Association expected this to provide a boost to the development of the UK private placement market, and called on the European Commission to consider introducing a pan-EU exemption.[41]

34. **We welcome the Commission's emphasis on promoting and developing the private placement market. We hope that the market-led approach advocated by the Commission proves successful. Member States must also play an active part in promoting investment-friendly environments for these markets to flourish.**

Credit information

35. The Green Paper states that information on SMEs is limited and usually held by banks. Although the Commission acknowledges that banks would remain an important financing option for SMEs, not least because of the strong presence of relationship-based finance, it believes that capital market funding could play an important role, in particular for small and rapidly growing firms.[42]

36. Lord Hill stated that an investor in one country currently did not have comparable ways in which to obtain information to understand the investment and the risk of investment in a business elsewhere in the EU.[43] The Commission suggests that the development of a common minimum set of comparable information for credit reporting and assessment could help attract funding to SMEs. The Commission plans to hold a series of workshops during 2015 on SME credit information.[44]

37. Andrew Van der Lem, Managing Director, Communications and Information, British Business Bank, said that while it was not easy for investors to access information on SMEs, there was also a sense of inertia among financial services providers and small businesses themselves. Barnabas Reynolds added that credit assessments were notoriously unreliable. In referring to debt capital markets, he said that credit scoring needed particular attention.

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40 International Capital Market Association, 'Pan-European Private Placement Working Group supports exemption from withholding tax on interest in private placements contained in HM Treasury's Autumn Statement' (5 December 2014): Available at http://www.icmagroup.org/media/Press-releases/ [accessed 5 March 2015]

41 Investment Association, *Putting savings to work: asset management and a Capital Markets Union that serves investors*, December 2014

42 COM (2015) 63 FINAL and accompanying Commission Staff Working Document, *Initial reflections on the obstacles to the development of deep and integrated capital markets*: http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/staff-working-document_en.pdf [accessed 5 March 2015]

43 Q 7

44 COM (2015) 63 FINAL

38. Michael Dakin, Partner at Clifford Chance, said that one problem with financing SMEs was the amount of effort needed to understand a particular business in order to make a meaningful investment decision. We were surprised by his assertion that it was difficult to get banks interested in enterprises valued below £50 million. Mr Dakin said that there needed to be more incentives for banks rather than individuals.

39. **The idiosyncratic and diverse nature of SMEs means that it is more difficult and proportionately more expensive to make a credit assessment of them. It will be difficult to shift the pattern of SMEs' reliance on bank financing, given the comparative advantages that banks have in assessing SMEs and the strong relationships that often exist between them. It is important to ensure that a bank's expertise in assessing and lending to SMEs should not be lost. Nevertheless, we welcome the Commission's efforts to widen the investor base for SMEs, given the problems that they have faced in attracting finance since the crisis erupted. The Commission's proposals to enhance the availability of credit information by developing a minimum set of comparable standards and promoting credit scoring are helpful steps, which would enable investors better to compare and assess SMEs. We look forward to further concrete steps being brought forward as a result of the workshops on SME credit information that the Commission plans to hold in 2015.**

Alternative financing

40. Online platforms such as peer-to-peer lending[45] and crowdfunding[46] have enjoyed considerable success with early stage businesses. In essence, online alternative finance is the direct connection, interaction and exchange between fundraisers and funders without the orthodox intermediation of traditional financial institutions. It is estimated that the online European alternative finance market grew by 144% in 2014, while early-stage growth and working capital funding provided €201 million to European start-ups and SMEs through the online market.[47] Yet the online alternative market operates largely within national borders, and the Green Paper states that there is little evidence of cross-border or pan-European activity. The Commission is in the process of gathering further information on industry approaches to information disclosure and Member State approaches to regulation.[48]

41. Bruce Davies, Director, UK Crowdfunding, asserted that the Internet was enabling new financial models to tap into latent demand for retail investments across national borders. However he was concerned that Capital

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45 Peer-to-peer consumer lending is a debt-based transaction between individuals whereby most loans are unsecured personal loans. Peer to Peer business lending is a debt based transaction between individual/institutional investors and existing businesses which are mostly SMES.

46 Crowdfunding can take many forms, but is based on the raising of capital, in small increments, from large numbers of people, and for a specific purpose.

47 Robert Wardrop, Bryan Zhang, Raghavendra Rau and Mia Gray, *Moving Mainstream: The European Alternative Finance Benchmarking Report*, University of Cambridge and EY (February 2015): http://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2015-uk-alternative-finance-benchmarking-report.pdf [accessed 5 March 2015]

48 COM (2015) 63 FINAL

Markets Union was too focused on top-down initiatives, rather than bottom-up models such as crowdfunding. The real problem was not capacity of capital but capacity of access. He added that there was a need to address how financial markets accessed SMEs and how SMEs accessed finance. He noted that the UK led the way on crowdfunding, and the model should be exported throughout the EU. In relation to investor and consumer protection, the Financial Services Consumer Panel suggested that peer-to-peer platforms should provide greater protection for consumers. The panel also supported requirements on the creditworthiness of borrowers that would bring credibility and stability to the industry.[49]

42. **The growth of online alternative financing platforms such as peer-to-peer lending and crowdfunding has considerable potential to increase access to finance for early stage and fast growing companies. Yet the growth of cross-border activity is hampered by the varying approaches of Member States. We encourage the Commission to undertake further analysis to determine adequate and appropriate measures at a national and European level to allow these markets to grow and develop across borders. It is important that these markets continue to provide support to early stage businesses, while ensuring an adequate level of protection for funders.**

Taxation

43. The Commission states that the tax treatment of different types of financing across Member States could be used to discourage excessive risk taking, unproductive capital market activity, or market distorting conduct. The corporate tax bias in favour of debt, due to the deductibility of interest payments, without a similar treatment for equity-financing, is cited as a prominent example.[50] Hugo Dixon stressed the need to remove the tax bias towards debt. He noted that while the Commission could not impose this on Member States, it could encourage them to do so. There would be "safety in numbers" if several Member States took action at the same time. Sharon Bowles agreed on the need for a level playing field between debt and equity, and noted that this was acknowledged policy at both EU and OECD level.

44. Lord Hill said that Capital Markets Union would rightly examine taxation law. Yet he acknowledged that this would involve more politically contentious areas, "which is one reason why I am keen to do things in a phased way".[51] This is particularly so because of the requirement for unanimity among Member States in relation to EU proposals in the area of taxation.

45. **Different tax treatment across Member States and between various types of financing could impede the development of genuinely pan-European capital markets. We note in particular the tax bias in favour of debt over equity. Nevertheless, the requirement for unanimity in EU taxation measures means that agreement on reform is difficult to secure. While we support the Commission in its efforts**

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49 Written evidence from the Financial Services Consumer Panel (CMU0001)

50 Commission Staff Working Document accompanying the Green Paper

51 QQ 5–6

to encourage greater consistency in tax treatment, this should not become a distraction from its attempts to bring about more easily achievable reforms.

Building a Capital Markets Union for consumers and investors

46. Capital markets need to attract retail, institutional and international investors, including savings and pensions, as a source of funding. The Green Paper states that the size of capital markets depends on this healthy supply of capital and its ability to flow into capital market instruments, promoting the diversification of funding sources. At the same time, principles of investor and consumer protection need to be met.[52]

47. Lord Hill said that he was keen to try to build a stronger Single Market in retail financial services, "so that we can deliver more tangible benefits for the peoples of Europe."[53]

Introducing capital markets to savers and investors

48. The Commission offers several explanations for current investment patterns across the EU, including a lack of trust in financial intermediaries, a lack of adequate financial expertise, and preference for real estate. It states, for instance, that real estate assets constitute 85% of gross total assets of households in the euro area. It also notes that significant sums of capital are being held in pension funds across Europe which could be more efficiently channelled through to long-term investment opportunities.[54] Lachlan Burn said that it was important that investment opportunities were created for those saving for retirement.

49. Joanna Cound, Managing Director at BlackRock, said that retail clients were not heavily invested in capital markets, and the question was how to create confidence for them to do so. In her view, the more focused on investors that Capital Markets Union was, the better.

Creating a diversified market

50. Capital Markets Union seeks to achieve a more integrated, deeper and diversified capital market by breaking down barriers that had led markets to fragment and products to be held back from development. As we have seen, Hugo Dixon said that, in developing other sources of finance, Capital Markets Union could have a cushioning effect as it would ensure that risk was spread more widely. This meant that the effects of a shock would be less concentrated.

51. Seminar participants confirmed that current financial instruments in the capital markets were not functioning adequately for investors or savers. Joanna Cound explained that investors were taking on greater risk as a result of current market conditions. She cautioned that fragmented liquidity in secondary corporate bond markets was placing execution risk on end investors. In addition, she explained that asset owners such as insurance companies needed to turn to high yield and emerging market investments in

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52 COM (2015) 63 FINAL

53 Q 1

54 Commission Staff Working Document accompanying the Green Paper

order to achieve the required yield necessary to meet their liabilities. Quantitative Easing was intensifying the difficulty. If one had more choice in financial instruments, for example in the form of bank loan funds, securitisation, and in private debt markets, then investment opportunities for investors would be diversified.

52. William Wright, Managing Director, New Financial, encouraged greater development and use of capital market instruments. He said that the venture capital market would have raised $200 billion more, the IPO[55] market would have raised $100 billion more, and the high yield bond market would have gained $700 billion more, totalling $1 trillion over 5 years, if EU capital markets had been as deep as in the US.

Consumer and investor protection

53. The Green Paper states that a key principle underpinning Capital Markets Union is the need for an effective level of consumer and investor protection.[56] Richard Metcalfe, Director of Regulatory Affairs, Investment Association, said that the Single Market was stronger on the wholesale side than on the retail side. He said that it was difficult to achieve retail distribution across the EU because of the patchwork approach to investor protection across Member States. While high level principles were in place, the detail of legislative texts could tilt the balance towards one product over another, products which could in turn be more widely distributed in one Member State than in another.

54. Joanna Cound said that while transparency, disclosure and certainty were important for end users, investors needed to be treated fairly not just at the point of sale but, as they held investments over time, even through to the point of recovery and resolution if necessary. Investors and savers needed to gain more access to advice and guidance in dealing with investment products. BlackRock suggested that one idea was to put in place minimum standards of guidance and qualifications for impartial financial and investment advisers.[57] The Financial Services Consumer Panel expressed caution about the greater use of automated investment advice, stating that such processes should be regulated and effectively operated.[58]

55. The consultation on the Prospectus Directive recognised that overly long documents might not be in the best interest of investors.[59] Lachlan Burn said that retail investors did not read long documents, and questioned why the Prospectus Directive required such extensive retail prospectuses when offering denominations for under £100,000. The Financial Services Consumer Panel argued that information in the prospectus needed to be consumer tested. The panel also proposed that a duty of care obligation be introduced, as has been incorporated into MiFID II.[60] David Doyle

55 Initial Public Offering

56 COM (2015) 63 FINAL

57 BlackRock ViewPoint, *The European Capital Markets Union: an investor perspective* (February 2015): http://www.blackrock.com/corporate/en-gb/literature/whitepaper/viewpoint-cmu-investor-perspective-february-2015.pdf [accessed 5 March 2015]

58 Written evidence from the Financial Services Consumer Panel (CMU0001)

59 *Review of the Prospectus Directive*

60 Written evidence from the Financial Services Consumer Panel (CMU0001)

highlighted the growing level of financial illiteracy among EU citizens: unless such tools as the Prospectus Directive and PRIIPs[61] factsheet were used, and the language used in them was simplified, people would risk making wrong investment decisions.

56. **We welcome the identification of investor protection as a key principle of Capital Markets Union, and support proposals to ensure that investors and savers have improved access to investment information and advice. We also welcome efforts to explore how new tools such as guidance can aid consumers and investors in dealing with investment products. It is important, while protecting investors, not to overburden them with information. It equally must be recognised that financial advisers and fund disclosure managers all require a high level of disclosure in order to fulfil their functions and responsibilities, which are so important for investors.**

Additional barriers preventing investment

57. The new financial regulatory framework has introduced new rules and requirements for a range of financial institutions and market participants, changing the structure and operations of EU banking and financial markets. While the single rulebook aims to achieve regulatory standards and minimum levels of harmonisation, several barriers have prevented certain products and markets from developing, inhibiting investment from a range of investors.

Stimulating long-term and infrastructure investment

58. The Green Paper acknowledges that several regulatory measures need to be reviewed to boost institutional investment. For example, it suggests that lower set-up costs and more cross-border marketing would make funds more competitive; and that infrastructure investment requirements could be tailored to match those mandated by insurers and banks.[62]

59. While European Long-Term Investment Funds (ELTIFs) are designed for investment managers to offer long-term investments to institutional and private investors, including infrastructure investment, further measures to stimulate investment may be required. Asset managers BlackRock supported increasing the supply of capital by transforming assets such as bank loans into more liquid securities, enabling them to be accepted as eligible assets under UCITS,[63] either directly, or indirectly through a pooled vehicle such as the ELTIF. BlackRock also argued that an ELTIF did not have the same ability as a UCITS fund to deploy raised capital cross-border, and that there were many barriers at the national banking level, as well as in insolvency laws and tax regimes. BlackRock called for the creation of an 'asset passport', which could be used by ELTIFs to provide capital on a level playing field with banks.[64] The Financial Services Consumer Panel stated that, by default, an ELTIF would not offer investors the possibility of redemption before the pre-defined end of the life of the fund. Unless the individual ELTIF made

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61 Packaged Retail and Insurance-Based Investment Products Regulation

62 COM (2015) 63 FINAL

63 Undertakings for Collective Investment in Transferable Securities

64 *The European Capital Markets Union: an investor perspective*

special arrangements to enable early redemption, investors should be made aware of the illiquid nature of the investment.[65]

60. Bernardita Jimenez, Director, Bank of Tokyo Mitsubishi, said that maturity transformation was a key competence in banking operations. Funds needed to be channelled towards long-term infrastructure projects, or long-term savings transformed into short-term financing, areas in which the banking sector had expertise.

61. **We welcome the Commission's commitment to amend existing regulations so as to encourage infrastructure investment, making it more cost-effective for funds to be set up and marketed across the EU. We call on the Commission to consider how European Long-Term Investment Funds might be encouraged to operate effectively across borders, accessing a wide range of investors in the EU and beyond.**

Securitisation for investors

62. The Commission consultation on securitisation states that the slow recovery of securitisation markets in the EU reflects concerns among investors and prudential supervisors about the risks associated with the securitisation process itself. It is worth noting that securitisations are not products for retail investors.[66]

63. In seeking to revive the market for larger scale investors, the Commission's consultation acknowledges that the EBA has determined that qualifying securitisations (those that are simple, standard and transparent) warrant a different and more risk-sensitive capital treatment.[67] While some regulation relating to securitisation (in the form of prudential treatment for insurers in Solvency II and liquidity of banks through the Liquidity Coverage Ratio) has been recently reviewed, there is appetite for further reform. Sharon Bowles said there was ambition to tackle further problems relating to investment in securitisation in the delegated acts in Solvency II and CRD IV[68] dealing with the Liquidity Coverage Ratio.

64. The Commission states that it is seeking a high quality framework to provide confidence to investors in the EU, and allow them to evaluate risks within and across products. However, investors would still need to conduct thorough due diligence, and should not rely solely on the new EU framework, as was the case with credit ratings.[69] The Investment Association said that originators should keep some 'skin in the game', in that retention requirements should operate as a threshold obligation on originators who wished to sell, rather than, as is currently the case in the EU, on investors who wished to buy.[70] The Association for Financial Markets in Europe also

65 Written evidence from the Financial Services Consumer Panel (CMU0001)

66 *An EU framework for simple, transparent and standardised securitisation*

67 *Ibid.*

68 Capital Requirements Directive IV

69 *An EU framework for simple, transparent and standardised securitisation*

70 *Putting savings to work*

supported harmonisation of rules on risk retention between different types of investors to create a level playing field.[71]

65. BlackRock argued that investor confidence was a particular issue when considering SME securitisations. While a level of information asymmetry between the originator/sponsor and investors existed, creating greater transparency would improve investor demand. This could be achieved by allowing comprehensive analysis and the identification of potential conflicts of interest through fully disclosed and documented terms.[72]

66. **We reiterate our support for the creation of a simple, transparent and sustainable high quality securitisation market that enjoys investor confidence. To that end, we support moves to create greater transparency, to enable investors to evaluate risks within and across products.**

Securities law and insolvency law

67. The European Commission states that the diversity and in some cases inadequacy of company and insolvency laws across Member States has made cross-border operations and investments by companies more difficult and costly. Rules on conflict of legal jurisdictions in the area of company law differ substantially, creating uncertainty for businesses. Differences in insolvency laws across the EU make it difficult for foreign investors to assess risk. The Commission sets out proposals to modernise insolvency laws, introducing minimum standards, with a view to benefiting creditors.[73]

68. The Green Paper notes that the demand for collateral has increased, while its fluidity is restricted.[74] In the context of insolvency law, Barnabas Reynolds questioned whether or not to harmonise protections for pledged collateral and title transfer to free up collateral. With regard to securities law, the Association for Financial Markets in Europe advocated EU legislation to clarify ownership of securities when trading cross-border, so as to provide confidence to investors trading outside their home jurisdiction.[75] The Investment Association argued that cross-border investment was being jeopardised by the legal risks inherent in holding securities via custodial intermediaries, creating chains with potential for a matrix of laws.[76]

69. Barnabas Reynolds said that market participants and service providers were holding back because of uncertainty over regulatory liability and lawsuits. There was particular concern over rights of recovery, given that there was no pan-European investor compensation scheme. The right of litigation was a good principle, but jurisdictional issues needed to be addressed in a cross-border context. He questioned the readiness for such a big step, given the lack of harmonisation of legal systems. The Commission highlights the fact

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71 Association for Financial Markets in Europe, *An agenda for capital markets union* (November 2014): www.afme.eu/WorkArea/DownloadAsset.aspx?id=12155 [accessed 5 March 2015]

72 *The European Capital Markets Union: an investor perspective*

73 Commission Staff Working Document accompanying the Green Paper

74 COM (2015) 63 FINAL

75 *An agenda for capital markets union*.

76 *Putting savings to work*

that it recently acted to urge Member States to adopt a new approach to business failure and insolvency.[77]

70. **The lack of harmonisation of legal approaches to such issues as securities law and insolvency law is a potential barrier to an effective Capital Markets Union. We welcome the Commission's efforts to encourage Member States to introduce minimum standards, for instance in relation to insolvency. Nevertheless, full harmonisation of legal systems remains a distant prospect, and we urge the Commission to prioritise the politically possible.**

77 COM (2015) 63 FINAL

CHAPTER 3: PITFALLS, OBSTACLES AND OPPORTUNITIES

71. We also highlight some potential pitfalls and obstacles to a successful Capital Markets Union, as well as the opportunities it might present.

Supervision

72. Several seminar participants expressed concern about any formal pan-EU supervisory mechanism. Hugo Dixon said that it was misleading to draw parallels with the Banking Union Single Supervisory Mechanism. He stressed the distinction between a single supervisor and a common rulebook, but conceded that there might be a case for supervision of some very technical areas.

73. Sharon Bowles said that the issue of centralised supervision would inevitably raise its head during negotiations. Although supervision might be necessary in specific areas, she said that there was no ready-made body to take on a pan-EU supervisory function, as the ECB had done under Banking Union. She did not think that it would be possible for ESMA to take on this role.

74. Charles Roxburgh said that the UK Government did not think that a pan-EU supervisory framework was necessary or desirable: the current Member State-based system worked, while trying to create a pan-EU framework could create a significant distraction. Phil Evans agreed that, from the Bank of England's point of view, pan-EU supervision was not necessary. Barnabas Reynolds did not think that new powers for ESMA were necessary. Nor was it in the interests of the ECB to become a pan-eurozone capital markets regulator, given its existing onerous responsibilities.

75. **Our recent report on *The post-crisis EU financial regulatory framework* made the case for strengthening the powers, role and resources of the three European Supervisory Authorities.**[78] **We also recognise the principled case for as much consistency across all 28 Member States as possible. There may well be a role for ESMA to play in overseeing specific aspects of Capital Markets Union. Yet a distinction must be drawn between consistent application of a common rulebook and direct supervision of capital markets at the EU level. Any attempt to establish a system of pan-EU supervision would not only be contentious, but could prove an unhelpful distraction from the necessary reforms that Capital Markets Union is seeking to bring about.**

SMEs

76. As we have seen, the Green Paper focuses in particular on the need to improve access to finance for SMEs. The Commission acknowledges that small and rapidly growing companies possess low levels of cash flow and depend on external finance to grow. It is also recognised that bank financing, leasing and factoring are often not available or sufficient for companies with significant intangible assets, which can be less easily used as collateral. The

78 *The post-crisis EU financial regulatory framework: do the pieces fit?*

Commission notes that the EU lacks risk capital, citing the relatively undeveloped venture capital market for SMEs.[79]

77. Many seminar participants highlighted the importance of SMEs to the European economy. David Doyle said that they generated 67% of GDP, over 70% of employment and constituted 99.8% of all enterprises. Yet Charles Roxburgh said that the US experience demonstrated that many small businesses did not and would not be able to access capital markets. He said that Capital Markets Union should therefore focus on medium-sized companies.

78. Marte Borhaug, Senior Policy Adviser, Financial Services at the CBI, said that the focus should be not just on the size of SMEs, but on whether they wanted to grow. A capital market needed to focus on companies with the ambition to grow: companies themselves needed to take the initiative. Sharon Bowles agreed, and noted that SMEs in the UK and the EU as a whole were not good at growing from medium to large firms.

79. As we have seen, Andrew Van der Lem said that there were limited data on SMEs, most of which were held by banks and not readily available to investors. According to Jonathan Faull, comparable credit information was needed, though there was a question as to how much detail was required. Ultimately the challenge was to keep investors interested without imposing excessive burdens on SMEs.

80. **The term 'SMEs' covers an extremely broad range of companies, varying not only in size but in their ambition and motivation to grow. Capital Markets Union is unlikely to benefit all such companies. Nevertheless, many will be well-placed to make use of the avenues for access to financial investment that Capital Markets Union could create. We urge the Commission to consider how those SMEs who want to take advantage of Capital Markets Union can be encouraged to do so. Yet ultimately, the onus lies on SMEs themselves to respond.**

International consistency

81. The Green Paper states:

> "European capital markets must be open and globally competitive, well regulated and integrated to attract foreign investment, which means maintaining high EU standards to ensure market integrity, financial stability and investor protection. Given the global nature of capital markets, it is important that the Capital Markets Union is developed taking into account the wider global context."[80]

82. A number of seminar participants compared the EU and the US. David Doyle pointed out that the US had a flourishing enterprise culture and ready availability of capital market-based intermediation funding. He pointed out that in the US 80% of capital funding came from capital markets and 20% from banks, whereas the reverse was true in the EU. According to Phil Evans, part of the reason the US was recovering faster than the EU was

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79 COM (2015) 63 FINAL

80 *Ibid.*

because all the increase in financing for corporates in recent years had come from capital markets rather than banks, which were deleveraging.

83. In light of these factors, Barnabas Reynolds said that it was vital to consider how Capital Markets Union would fit with the US model, in particular from the UK's point of view, given that London was the gateway to US financial markets. It was important to ensure that it was not too "European-centric". Andrew Van der Lem said that the EU could learn from the US model. Its Small Business Administration played a key role in diversifying the market, investing in debt funds and lending on to small business, thus creating a market and a track record which attracted institutional investors. He thought that the European Investment Bank and European Investment Fund could play a similar role.[81]

84. Michael Dakin agreed that the Small Business Administration was a good model, partly because it took the first loss and spread risk. He also stressed the need for co-ordination across jurisdictions, not only between the EU and US, but also with Asia. Disclosure standards in the US, for instance, would have implications in the EU. Jonathan Faull agreed that the US had very detailed data requests and they stressed that EU requirements needed to dovetail with international standards.

85. **The EU has much to learn from the development of US capital markets as a source of funding. The Commission should look to US models such as the Small Business Administration, to see if similar programmes can be adopted, whether at EU or Member State level. The EU must also ensure that Capital Markets Union contributes to, rather than conflicts with, the development of consistent international standards. In that light, we stress the importance of international co-operation and co-ordination, not only with the US but with other, growing, global markets. A failure to include financial services regulatory matters in the Transatlantic Trade and Investment Partnership (TTIP) would be a missed opportunity.**

The need for realism

86. Several participants stressed the need for realism about the challenges that Capital Markets Union would face. Hugo Dixon said that capital markets were not fail-safe, and risk could only be reduced rather than eliminated entirely. Lord Hill said that "nil risk means nil growth, and I do not want the stability of the graveyard."[82]

87. Participants also said that capital markets should complement, not displace, the banking sector. Phil Evans said that the EU's heavy reliance on banks would not change, though the balance between banks and capital markets could be shifted. Bernardita Jimenez said that the financial system should be treated as an integrated whole, not as a collection of silos. As we have seen, she argued that Capital Markets Union presented opportunities for banks. Sharon Bowles agreed that banks had a role to play in growing the markets.

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81 Mr Van der Lem also stressed the work undertaken by the British Business Bank in the UK in relation to crowdfunding and venture capital. See Appendix 3.

82 Q 4

88. Graham Bishop cautioned that similar issues had been discussed before, in the context of the Financial Services Action Plan and the Giovannini process:[83] it was disturbing that barriers like securities law and tax mechanisms, which had been identified then, were still a problem.

89. William Wright drew attention to the huge disparities between EU Member States. Whereas the UK stock market was 130% of the size of its GDP, many Member States had stock markets comprising only 10–20% of GDP, or even less. Standards, protocols and systems needed to be introduced for Member States with under-developed capital markets.

90. **Amid the positive reaction to Capital Markets Union, it is important to retain a sense of perspective. Significant obstacles remain. Capital markets cannot, and should not, replace the banking sector, but rather should complement it as an alternative source of funding for economic growth. It is important that the financial sector is treated as an integrated whole, rather than as a set of silos. The state of development of capital markets varies considerably between Member States, and the needs, cultures and priorities for Member States without developed markets will differ significantly from those such as the UK, where capital markets are relatively well developed.**

91. **We welcome the short-term initiatives that the Commission has identified. We also recognise that there are longer-term, more contentious issues that will need to be tackled if a true Capital Markets Union is to be created. Yet the sheer quantity of proposals that the Commission has set out in its Green Paper creates a danger that Capital Markets Union could lack focus. A good starting point would be to identify those measures that are most necessary to support the EU's jobs and growth agenda.**

An opportunity for the UK

92. Notwithstanding these caveats, there was widespread recognition that Capital Markets Union presented a significant opportunity for the UK. Sharon Bowles said that President Juncker had acknowledged that Capital Markets Union could not be achieved without the UK and London. Hugo Dixon said that more than half of all capital markets activity in the EU came through the UK. Boosting capital markets would therefore be a fillip to the UK economy and to the City of London in particular.

93. David Doyle stressed that the UK should act as a constructive participant encouraging best practice. Charles Roxburgh said that the UK also needed more effective capital markets, and could learn from others. Capital Markets Union would help expand financial centres across the EU, not just the City of London. The aim was to make the cake bigger for everyone.

94. **Capital Markets Union presents a significant opportunity for the UK positively to promote the importance of capital markets, benefiting**

[83] The Giovannini Group was a group of financial market experts, formed in 1996 to advise the European Commission on financial market issues. In particular, the work of the Giovannini group focused on identifying inefficiencies in EU financial markets and proposing practical solutions to improve market integration. See https://www.ecb.europa.eu/paym/t2s/about/html/giovannini.en.html. [accessed 5 March 2015]

not just the UK economy, but the EU as a whole. We encourage the Government and the UK financial sector to do all they can to share best practice with other Member States, while recognising that the UK can itself learn from others. The UK must ensure that it is at the forefront of the debate as the Capital Markets Union agenda takes shape in the coming months.

95. **It will not suffice simply to react to others' proposals: the City and the Government should be active in responding to the Commission's initiative.**

Overview and key conclusions

96. **We welcome the Commission's proposals for Capital Markets Union, as a vital means of unlocking investment and providing finance for SMEs, with the potential to boost economic growth in the EU as a whole. At the same time, we make the following observations:**

- **As it takes its proposals forward, the Commission must balance the need, on the one hand, to ensure that companies have sufficient access to capital and investment opportunities, and are not overburdened by onerous requirements with, on the other, adequate protection for consumers and investors.**
- **The Commission must also ensure that Capital Markets Union remains focused on jobs and growth.**
- **The Commission is right to propose a balance of short-, medium- and long-term measures, and legislative and non-legislative proposals, but must take care that Capital Markets Union does not lose focus through the sheer number of ideas on offer.**
- **The Commission must also ensure that all its proposals are subject to a rigorous Impact Assessment and cost-benefit analysis.**
- **A differentiated approach must be taken, reflecting the specific characteristics of each element of the EU's capital markets. At the same time, capital markets should not be treated in isolation, but rather as an integral set of transactions and relationships within the wider financial system.**

97. **Capital Markets Union presents an opportunity to break down obstacles to the creation of a properly-functioning Single Market in capital. We will scrutinise the Commission's proposals closely as they take shape in the coming months. Our initial assessment of this timely initiative is positive.**

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Lord Balfe
Viscount Brookeborough
The Earl of Caithness
Lord Carter of Coles
Lord Davies of Stamford
Lord Dear
Lord Flight
Lord Hamilton of Epsom
Lord Harrison (Chairman)
Lord Kerr of Kinlochard
Lord Shutt of Greetland
Lord Vallance of Tummel

Declarations of interest

Lord Balfe
Specialist Director, CERN Pension Fund; a fee is paid per meeting attended plus travel, hotel and any other incidental expenses.
Chairman, European Parliament Members' Pension Fund
Shareholdings in: Hargreaves Lansdown, Diageo, Reckitt Benckiser, Rio Tinto, Astra Zeneca, GlaxoSmithKline PLC, Smith and Nephew, Law Debenture
Speaking Engagement, 12 May 2014; chaired Annual Conference of Law Debenture UK

Viscount Brookeborough
No relevant interests declared

The Earl of Caithness
Consultant, Rickett Tinne Estate Agents
Share Portfolio managed by JM Finn & Co on a fully discretionary basis
Guest at lunch hosted by British Bankers' Association, 17 July 2014
Guest at lunch hosted by Swiss Bankers' Association, 19 November 2014

Lord Carter of Coles
Director, JKHC Ltd
Director, Health Services Laboratories LLP
Director, Primary Group Ltd, and also of the following subsidiary companies: PGUK HAB Ltd; Qmetric Group Ltd; UK General Insurance Ltd; UK General Insurance Group Ltd
Chair, NHS Procurement & Efficiency Board
Adviser, Warburg Pincus International Ltd
Shareholdings in: JKHC Ltd (business services), The Glenholme Healthcare Group Ltd (care and rehabilitation centres), Diageo PLC (drinks), Imperial Tobacco Group PLC (tobacco), IMI PLC (engineering solutions), Compass Group PLC (catering), HSBC Holdings PLC (banking/financial), Pearson PLC (education), Prudential PLC (insurance), Lloyds Banking Group PLC (financial), BG Group PLC (gas), GlaxoSmithKline PLC (pharmaceuticals), Weir Group PLC (engineering solutions), Verizon Communications Inc (telecommunications), JP Morgan Chase & Co (financial), Home Depot Inc (retail), Johnson & Johnson (retail), CVS

Caremark Corporation (pharmaceuticals), United Technologies Corp (technology), Deutsche Post AG-REG (logistics), BASF SE (chemicals), Banco Bilbao Vizcaya Argenta Euro.49 (corporate bond), Nestle SA (food/retail), ING Group (insurance), Google Inc-CL A (technology), Royal Dutch Shell (oil and gas), Inmarsat PLC (satellite communication), Unilever PLC (retail), Vodafone Group PLC (telecommunications), Whitbread PLC (retail), Visa Inc (financial), United Utilities Group PLC (utilities), EOG Resources Inc (aerospace/defence), WPP PLC (advertising), United Rentals Inc (rental company), Caledonia Investments PLC (investments), GW Pharmaceuticals PLC, McKesson Corp (IT HR and payroll), GlobalAccess Global High Yield Bond Fund M Distribution GBP, Jupiter Strategic Bond Fund 05–perp pref shsl, FRN Barclays Bank PLC (corporate bond), 2% Canadian Government Bond Snr 01 Dec 14 (government bond), Polar Capital Global Technology Inst GBP Inst (fund), Henderson European Special Situations GBP Inc Inst (fund), GlobalAccess US Small & Mid Cap Equity Fund (M Distribution USD), Findlay Par, American Smaller Cos USD (fund), Schroder UK Opportunities Z Acc GBP (fund), Brown Advisory FDS American Dollar CLS B USD (fund), Mondelez International Inc-A (fund), Martin Currie UT China B ACC Nav (fund), Newton Asian Income Institutional W GBP Inc (fund), iShares FTSE EPRA/NAREIT Asia Property Yield Fund, First State Asia Pacific Leaders B GBP Acc (fund), GlobalAccess Global High Yield Bond Fund M Accumulation GBP, Safran SA (aerospace/defence), Google Inc-CL L (technology)
Chair, Property Advisory Panel
Member, Efficiency and Reform Board

Lord Davies of Stamford
Shareholding in HSBC

Lord Dear
No relevant interests declared

Lord Flight
Chairman, Aurora Investment Trust PLC
Director, Edge Performance VCT PLC
Chairman, Flight & Partners Limited
Director, Investec Asset Management Limited
Chairman, CIM Investment Management Limited
Chairman and shareholder, Downing Structured Opportunities VTCI PLC
Director, Metro Bank PLC
Director, Marechale Capital
Director, Investec Asset Management Holdings (Pty) Limited
Director, R5 FX Limited
Commissioner, Guernsey Financial Services Commission
Consultant, Kinetic Partners
Trustee, IAM Pension Fund
Consultant, Tax Incentivised Savings Association (TISA)
Chairman, EIS Association
Consultant, Arden Partners
Member Investment Committee, Guinness Renewable Energy EIS Fund
As Chairman, EIS Association (representative body for lawyers, accountants, promoters of EIS qualifying companies), public affairs advice is provided to the Association
As Consultant to TISA (representative body for retail investment management industry), public affairs advice is provided to TISA

Shareholdings in: Flight & Partners Limited, Flight & Partners Recovery Fund, Metro Bank PLC
Director, Flight & Barr Limited (dormant company)
Director, Gulf Overseas Investment Fund Limited (private investment fund)
Member of Advisory Board Praesidian Capital Europe
Member of Advisory Board, Centre for Policy Studies
Member of Advisory Board, Institute of Economic Affairs
Member of Advisory Board, Financial Services Forum

Lord Hamilton of Epsom
Non-Executive Director, Jupiter Dividend and Growth Trust PLC
Director, FM Capital Partners Ltd
Director, IREF Global Holdings (Bermuda) Ltd
Director, IREF Australian Holdings (Bermuda) Ltd
Director, AREF Holdings (Bermuda) Ltd
Director, Sovereign Business Jets
Shareholdings in: Nordea Bank AB (banking), Findlay Park American Fund, Hermes International Fund, Powershares Exchange Traded FD Buyback Achievers
Share portfolio managed by JP Morgan American IT on a fully discretionary basis
Share portfolio managed by Findlay Park American FDS on a fully discretionary basis

Lord Harrison (Chairman)
Trustee, Genesis Initiative (Business Senate for Enterprise)
Vice President, Wirral Investment Network (WIN)
Guest at lunch hosted by British Bankers' Association, 17 July 2014

Lord Kerr of Kinlochard
Deputy Chairman and shareholder, Scottish Power PLC
Non-executive Director and shareholder, Rio Tinto PLC
Non-executive Director, Rio Tinto Ltd (Australia)
Director and shareholder, Scottish American Investment Co Ltd
Member, International Advisory Board, Edinburgh Partners
Shareholding in Royal Dutch Shell PLC
Shareholding in European Investment Trust
Chairman, Centre for European Reform
Vice President, European Policy Centre
Council Member, BNE (London)
Council Member, BI (London)

Lord Shutt of Greetland
Chartered Accountant (non-practising)
Shareholding in Bank of Ireland (spouse)
Guest at lunch hosted by Swiss Bankers' Association, 19 November 2014

Lord Vallance of Tummel
Chairman, Amsphere Ltd
Chairman, De Facto 479 Ltd (family owned investment company)
Member, International Advisory Board, Allianz SE
Chairman, Board of Royal Conservatoire of Scotland (RCS)
Share portfolio managed by Smith & Williamson on a fully discretionary basis

The following Members of the European Union Committee attended the meeting at which the report was approved:

Lord Boswell of Aynho (Chairman)
The Earl of Caithness
Baroness Eccles of Moulton
Lord Foulkes of Cumnock
Lord Harrison
Baroness Henig
Lord Kerr of Kinlochard
Lord Maclennan of Rogart
Baroness O'Cathain
Baroness Prashar
Baroness Quin
The Earl of Sandwich
Baroness Scott of Needham Market
Lord Tugendhat
Lord Wilson of Tillyorn

During consideration of the report the following Members declared an interest:

Lord Boswell of Aynho (Chairman)
Shareholdings in two financial services companies (Barclays and Allianz)
Baroness Eccles of Moulton
Shareholdings in: BP plc (oil), Royal Dutch Shell "B" (oil and gas), GlaxoSmithkline (healthcare), SSE plc (utilities), Centrica plc (electricity and gas), Pennon Group plc (utilities), HSBC Bank plc (banking) and Close Brothers Group plc (financial services)
Baroness Henig
Chairman-elect, Phinancial Ltd (financial services company)
Baroness O'Cathain
Holder of several financial products with HSBC
Lord Tugendhat
Shareholdings in: A portfolio of investment vehicles managed on behalf of member and his wife and at their discretion by Coutts & Co; A portfolio of mainly but not exclusively US$ denominated funds, fixed interest stocks, preference shares and equity held and managed on behalf of member and his wife by Royal Bank of Canada, that includes: Barclays Bank PLC, HSBC Holdings Brazil SA (banking), Lloyds Bank PLC, Morgan Stanley Capital (banking), Marks and Spencer PLC (retail), Royal Bank of Canada (banking), Volkswagen International (automotive), ETFS Commodity Securities (alternative investment vehicle dealing in crude oil); Rio Tinto (mining); Biotech Growth Trust (biotech investment trust)
SIPP managed on member's behalf and at their discretion by Standard Life
Term deposits with Coutts & Co, and Nationwide Building Society
Member, Advisory Council, Trilantic Capital Partnership, which invests in business in which Member sometimes takes a stake
Member of Advisory Council, Official Monetary and Financial Institutions Forum Limited (independent research and advisory group and a platform for confidential exchanges of views between official institutions and private sector counterparties)

A full list of Members' interests can be found in the Register of Lords' Interests: http://parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at www.parliament.uk/capital-markets-union and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below.

Oral evidence

*	Lord Hill of Oareford, European Commissioner for Financial Stability, Financial Services and Capital Markets Union	QQ 1–15

We are grateful to Lord Hill for agreeing to appear before the Committee. In addition, the Committee held a stakeholder seminar on Capital Markets Union. A note of the discussion is included in Appendix 3.

Written evidence

No formal Call for Evidence was published. However the following organisation sent the Committee written evidence.

**	Financial Services Consumer Panel	CMU0001

In addition, a number of organisations sent the Committee material that had previously been published or produced. As such, this material has not been treated formally as written evidence. However this material is cited in the report where appropriate.

APPENDIX 3: NOTE OF STAKEHOLDER SEMINAR MEETING, 10 FEBRUARY 2015

Lord Harrison opened the seminar by welcoming attendees and introducing the four panellists. He said that the seminar would form part of the Committee's short inquiry into Capital Markets Union, and that a note of the discussion would be published as an appendix to the report.

Hugo Dixon, Columnist and commentator at Thomson Reuters, asked what Capital Markets Union was. He said it had been undefined and had been a slogan in search of a policy prospectus. However the big picture was now becoming clear. The EU system was bank-centric and Capital Markets Union would boost non-bank areas. He said that non-banking sector and capital markets were sometimes regarded as synonymous but there were subtle differences. A key question was whether it should be called Capital Markets Union or a Single Market in capital. The term Capital Markets Union was more likely to secure support from continental colleagues. However there was a risk it would be seen as analogous with Banking Union when the two were different. Banking Union was for the eurozone whereas Capital Markets Union was for all 28 Member States. The UK was dominant in the sector—more than half of capital markets activity came through the UK. Banking Union was about supervision and rescuing the eurozone from potential collapse, whereas Capital Markets Union was about freeing up markets.

Mr Dixon said that there was a need for a healthy Capital Markets Union. He cited five advantages. First, there would be more finance for growth. Banks were rightly on the back foot and would be constrained in the future, so there was a need for other sources of finance. This had helped the US economy bounce back more quickly. Second, it could have a cushioning effect. The economic crisis had led to banks being infected, which in turn led to a further downturn in the economy, leading to government intervention. There would still be a risk in the banking system, and capital markets were not fail-safe. But it would ensure that risk was spread more widely, meaning that the effects of a shock would also be less concentrated and would not rebound on investors. Third, Capital Markets Union was not a short-term fix. If there was another bout of deflation, the ECB and the Bank of England would not have to rely on government bonds. In the US, all sorts of instruments had been purchased with Quantitative Easing. Fourth, it would combat the concentrated bank market seen across Europe and boost competitiveness. The solution was either to break up banks or to increase outside competition. Fifth, if one wanted the UK to remain in the EU, then boosting capital markets would be a boon to the UK economy and to the City in particular as the main supplier of these services to consumers on the continent.

Having said all this, the detail was fearfully complex. There were two issues of principle. First, how much regulation or deregulation would be involved? It would be a mix of both. In order to create a Single Market, rules were needed to sweep away vested interests in national markets. Regulation was also needed to encourage common standards and harmonisation. Deregulation was needed to lighten burdens from the last few years that were strangling growth. For instance, rules on capital for insurance companies were a mistake and were being lightened. Second, the issue of supervision was a controversial one. Some advocated it as analogous with the single supervisor under Banking Union. He disagreed, because Banking Union and Capital Markets Union were different. There was a need to distinguish between a single supervisor and a common rulebook that you needed and should be consistently applied. The former would contravene the subsidiarity principle. But there may be a need for supervision of some very technical areas, such as shadow banking, even though this was not traditionally defined as a capital market. The Bank of England had increased its supervision of the sector, and it may be appropriate for the ECB to do so, albeit only in the eurozone. This did not mean there needed to be a single supervisor for Capital Markets Union.

David Doyle, EU Financial Services expert, **The Genesis Initiative** said that Capital Markets Union was a logical continuation of the late 1990s Financial Services Action Plan. It was also the logical next step to the Banking Union. The lack of a unified EU capital market that benefited small and large companies, pensioners, savers and consumers had still not been addressed. It had remained distinctively work-in-progress. There were two reasons why it was being brought forward now. First, the eurozone economy remained sluggish eight years after the crisis erupted. There was 11.4% unemployment and a record number of small businesses collapsed because of the economic situation (between 2009 and 2011, an average of 200,000 firms went bankrupt in the EU each year). Second, SMEs played a core role in the EU economy. Unlike the US, SMEs in the EU contributed to over 60% of GDP, over 70% of employment and constituted 99.8% of all enterprises. But they relied disproportionately on bank funding. This created a concomitant vulnerability for the EU economy. MEPs had sometimes been less enthusiastic about replicating the US model, but the US had a flourishing enterprise culture and a ready availability of capital market-based intermediation funding. In the US, 80% of funding came from capital markets and 20% from banks, whereas in the EU the reverse was true.

Mr Doyle said that Capital Markets Union would build on Banking Union but, by contrast, it would apply to all 28 Member States. He said that Capital Markets Union was critically important and that there was a case for boosting capital markets funding. The paucity of risk capital, together with the underdeveloped capital markets in Europe, were impeding EU growth and jobs. The pensions-funding deficit across the whole of the EU added further urgency. He cited barriers such as providing insurance coverage across borders. There were entrenched cultural norms in Europe, which meant that retail investors in shares and bonds retreated behind their national frontiers. Some 94% of European citizens shied away from buying a foreign financial product. Savings tended to be compartmentalised within Member States, and were also too concentrated in the national banking systems. In order to set up a bank account in another Member State, a citizen needed to overcome a range of local impediments. Thus, over the years, a complex and restricted approach to providing funding and saving had been built up. The market for funding small industry, individuals and households was not deep nor liquid enough. There was a need to overcome such obstacles.

Mr Doyle cited the need for radical change to the Prospectus Directive. The EU had updated it twice in 12 years but it remained complex, involved too much information disclosure and was expensive for a public equity offer of €5 million in terms of the cost of producing a prospectus. There was a need for a common rulebook approach to simplifying the EU Prospectus rules. A sustainable market for high-quality securitisation was needed, and it was necessary to revisit Solvency II, which made it unfavourable for insurance companies to significantly invest in equity, and other asset classes, while low interest rates contributed to negative-yielding securities. Tax regulation favoured bonds over shares. Private placement needed to be created from scratch in many Member States, let alone be reformed.

He said that the UK could be a constructive participant encouraging best practice in this field. But there may also need to be acceptance of a measure of centralised policy-making and regulation, especially given the divergence across the EU Member States' legal systems, that is, Civil Law versus Common Law.

Sharon Bowles, former MEP and former Chair of the European Parliament Economic and Monetary Affairs (ECON) Committee said that the term Capital Markets Union had been around for longer than was realised. It surfaced again a year ago, but its origins were wide, some of which pre-dated Banking Union. Some saw it as a eurozone complement to Banking Union, but it was not tied to the eurozone because capital markets were multinational and multicurrency rather than being a structural part of the doom loop, which Banking Union sought to solve. The notion of a eurozone Capital Markets Union no longer existed. President Juncker had said that it could not be done without the UK and London. There was lots of empty space to fill. It continued the Financial Services Action Plan but with more vigour. It also belonged to a family of 'Unions', including the digital union and energy union. All Member States recognised that strengthening capital markets was an issue of financial stability. There had been a shift in the position of Member States and MEPs traditionally suspicious of capital markets.

Sharon Bowles added that Banking Union was not isolated from other regulation, but was based on the Capital Requirements Directive and Regulation. There was already an existing framework of market regulation contained in MiFID, UCITS, EMIR,[84] on CCPs,[85] CSDs,[86] market abuse, OTC[87] derivatives and so on. Capital Markets Union would not build another framework like this. There would not be another massive programme of legislation. Giovannini barriers had not all been taken down, as cross-border issues remained, in particular the difficult issues in relation to law and tax. The leaked Green Paper said that there would be short-term, medium-term and long-term measures. A review of the Prospectus Directive would make it easier to raise funds. She bemoaned the different implementation between supervisors of the Prospectus Directive, and the lack of coherence that resulted. She pointed out that the toughest regime was in the UK, so if the UK wanted a lighter-touch approach, it needed to get its own regulators on board. There was also a need for a level playing field between debt and equity. This was policy at both EU and OECD level, and some aspects would come in when implementing the base erosion and profit shifting proposals. The UK would be an early implementer of these. There was a need to reduce the number of occasions when a new prospectus was required because it was too expensive for small companies.

On improving credit information, Sharon Bowles said that Italy and its central bank were leading the way, collecting lots of data. Basel had adopted a tough regulatory approach to changing trade financing because of the lack of data. There was a need for data in relation to sustainable and high-quality securitisation. Securitisation had not been too problematic in the EU but it had suffered from the reputational damage caused in the US. She cited the EBA's work on securitisation and the Prime Collateralised Securities label. There was ambition to tackle the

84 European Market Infrastructure Regulation

85 Central Counterparty Clearing House

86 Central Securities Depositaries

87 Over the Counter

problem as well in the delegated acts in Solvency II and CRD IV dealing with the liquidity coverage ratio. It remained to be seen whether this could overcome the Level 1 content. Something needed to be done on SME loans but this was difficult because of due diligence requirements and their short-term nature, in particular given the requirements for transparency. There was a dilemma for disclosure in relation to SMEs looking to issue bonds, in particular at the innovation stage. She said that the private placement initiative needed to be up and running and implemented. There could be no enforcement mechanism without EU regulation. An industry standard would have no enforcement mechanism if local preferences surfaced. There was also a need to develop ELTIFs. A long-term measure was the EU covered bond market. While this was a sacred market in Germany, there was a need for definitions because it meant different things in different places. MiFID showed the way to better bond markets in relation to non-equity rules. She also stressed that the UK needed to bring gilt bond markets up-to-date with electronic trading. The UK was 25 years behind EU counterparts in this respect. Finally, she said that the issue of centralised supervision would raise its head. Certain things might be required for certain issues but there was no ready-made supervisory body like the ECB for Banking Union. Neither was it possible for ESMA to grow into this role.

Barnabas Reynolds, Partner, Shearman and Sterling, said that the proposals were hugely welcome for the UK and the EU. It was an opportunity for liberalisation and there was a need for a pan-EU approach. EU markets were held back by a lack of harmonisation. There was a need for pan-EU directives and regulations. There was often a complaint that the EU could not move backwards. This was an opportunity to move some things back, in particular with regard to the accumulating impact of recent measures taken for systemic risk purposes. The regulatory framework now went too far and needed to be revisited in terms of its cumulative impact. There was also a need to look at bank regulation and non-bank regulation as it related to Capital Markets Union because of the vast amount of cash available in securities and given the interplay between banks and shadow banking sectors. There was an opportunity for a reversal of course where this made sense. ESMA, the EBA and the ECB would all be relevant. From looking at the leaked Green Paper new powers for ESMA were not necessary. The relative weighting of ESMA and the EBA powers needed to be looked at. The EBA was something of a pygmy in comparison with ESMA. He argued that responsibility for derivatives (where a lot of the regulation was prudential) should be transferred to the EBA, with ESMA becoming a conduct regulator. It was not in the interests of the ECB to become a pan-eurozone capital markets regulator, in particular as it already played a weighty role. He was not convinced that the tie-break mechanism in the EBA would be sufficient protection of the UK's interests. There was no such mechanism in ESMA. There was a need to look at the eurozone/EU dilemma, and at the constitutional issues that arose.

Mr Reynolds said that the retail market proposals were the most ambitious, in particular the rights of recovery with no pan-European investor compensation schemes. The principle of right of litigation was good but the jurisdictional issues needed to be thought about in a cross-border context. What if a UK entity had to make onerous payments as the result of a French court case, or *vice versa*? The application and interpretation of rights was key. He questioned whether there was sufficient readiness for such a big step given the lack of harmonisation of legal systems. Was it a step too far? Given the differences between national markets, trying to tear everything up and harmonise everything was too ambitious. There was a need to recognise national differences. SMEs were the main target of Capital

Markets Union. However there was a sliding scale of SMEs in terms of their size and turnover. The IFRS[88] and Prospectus Directive proposals to liberalise and simplify information were important, but there was also a need to look at investor protection. Large SMEs would be able to offer more than small ones, so there could maybe be a sliding scale. However, investor protection was needed otherwise the system would fall into disrepute.

There was also an issue in terms of application of the law. Debt listings in Ireland and Luxembourg, for instance, gave rise to arbitrage issues. ESMA was meant to iron these issues out but it hadn't been successful. He agreed with Sharon Bowles about securitisation. Debt capital markets and increasing publicly available credit scoring also needed to be thought about. Credit assessments were notoriously unreliable and there had been an emphasis on rolling back the overreliance on Credit Rating Agencies. The proposals were now moving in the opposite direction. In the context of insolvency law, he questioned whether to harmonise protections for pledged collateral and title transfer to free up collateral. The proposals were welcome but challenging nevertheless. He said that the UK benefited from less regulation of wholesale markets and lending. There was a concern about any unnecessary regulation resulting from this initiative. London was the gateway to the US and so stood to be a huge beneficiary of Capital Markets Union. As a result it was also vital to think about how the proposals fitted with the US model and were not too European-centric. The UK had the biggest interest in ensuring that this was done.

Lord Flight said that he supported the objective of Capital Markets Union but said that the UK's model was a successful one. There was a need for separate legislation in each Member State rather than pan-EU regulation. He called on other Member States to look at what the UK had done and copy its model.

Barnabas Reynolds said that it would not happen like that, and there therefore needed to be some pan-EU regulation.

Jonathan Faull, Director-General for Financial Stability, Financial Services and Capital Markets Union , European Commission, said that the Green Paper had not yet been agreed and was about to be released. He also stressed that it was a Green Paper and therefore raised more questions than it answered. He said that the panellists had touched on the main issues and he agreed with much, although not all, of their analysis. The Green Paper would set out short-term, medium-term and long-term goals. There was an urgency to take forward the short-term measures because capital markets needed to work better. Banks had become more risk-averse often for good reasons, and a comparison of the availability of non-bank finance between the EU and the US showed that we would be missing a trick not to explore it in the wider context of the Single Market. The principle of free movement of capital was contained in the Treaty of Rome (1957), so implementation had obviously not been easy. There was a need to tackle the constraints of legal and cultural traditions in Member States.

Mr Faull said that the Green Paper was reasonably ambitious but not unrealistic. It would ask a set of questions. The second phase would involve a more detailed action plan later in the year. Capital Markets Union was not a repeat of Banking Union or the large volume of legislation that had been enacted in the EU in recent

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years. There would probably be some legislation needed to regulate or deregulate. There would also be non-legislative action, for instance making use of Country-Specific Recommendations as a tool of persuasion. It was important to promote the successful work of some Member States as a best practice tool. It was also important to deal with the past. Mr Faull confirmed that there would be a review of existing legislation including an assessment of the cumulative impact of regulatory reform. Some adjustments might be necessary. His hope, and Lord Hill’s ambition, was that by 2019, Capital Markets Union would be seen to have been created for all 28 Member States and that it would be far more than a slogan in search of a policy (a reference to a previous speaker's description). There would be some banana skins along the way, including perhaps a temptation to take policies forward among some Member States only, but this was not the approach favoured by the Commission.

Charles Roxburgh, Director-General, Financial Services, HM Treasury said that the Government awaited the Green Paper. Although the consultation period would overlap with the purdah period the Government would respond before the purdah period began. The Government had strongly supported the aims and aspirations of Capital Markets Union since the idea was first aired. There had been a longstanding ambition to deepen capital markets. The UK also needed more effective capital markets. The Government also supported the process proposed by Lord Hill, including an exploration of the barriers as to why pan-EU capital markets had not yet developed. The Government supported short-term action but some barriers were deep-rooted, such as the home market bias and the cultural resistance of entrepreneurs to give up control by floating companies. He hoped that the Green Paper could set up a process to address these barriers over the longer term. The focus was on SMEs. Capital Markets Union had to deliver for them but one needed to be realistic that many small business did not and would not be able to access capital markets, as the US demonstrated. The focus rather was medium-sized companies. Emphasis should be on the benefits of freeing up bank balance sheets through securitisation of mortgages and mid and large company assets, which would enhance lending capacity to small businesses. Proposals like access to credit information, private placement and mini-bonds as seen in Italy were all good ideas, but it was important not to over-promise.

The UK did not think that a pan-EU supervisory framework was necessary or desirable. In relation to CCPs, both the Government and the Bank of England had stressed that ultimate responsibility should lie with home authorities. There was both a principled and practical objection. The current system worked and attempting to set up pan-EU supervision would prove a huge distraction. Mr Roxburgh stressed that Capital Markets Union would help expand financial centres across the EU, and there would need to be financial centres serving their localities. The idea was to make the cake bigger rather than London taking a bigger share. There were also opportunities to learn from others. Private placements were more developed in France and Germany, for instance. The UK was keen to import best practice from elsewhere that worked. Overall, the Government was enthusiastic. Capital Markets Union could be a combination of practical short-term reforms and a deeper insight into the barriers that prevented capital markets from realising their full potential.

Phil Evans, Director (International), Bank of England, strongly agreed that pan-EU supervision was not necessary. He said that Capital Markets Union sought to achieve three things. First, a better match of borrowers and investors—known as ‘allocative efficiency’. Second, to diversify financing for corporates. The heavy reliance on banks would not change but it was a question of degree and the need to shift the balance. In terms of the change in net financing for corporates in recent years, all the increase had come from capital markets rather than banks, which have been deleveraging. This was one reason why the US had recovered more quickly. Third, Capital Markets Union would build more risk-sharing across EU Member States. This would help in terms of the response to shocks. The US did more on cross-state risk sharing compared to the EU, which helped it respond to a crisis. This would benefit the UK and, in particular, the eurozone.

Bruce Davies, Director, UK Crowdfunding, said that the latent demand for crowdfunding was because of the Internet. It was a bottom-up process, while he was concerned that Capital Markets Union was a top-down approach. However SMEs wanted investment and wanted to move to where funding was available. The UK led on crowdfunding. There were lots of barriers including the Prospectus Directive and different interpretations of when it applied. It was not an issue of capacity of capital but instead capacity in access, not only for non-bank lenders that wanted access to those assets. In particular, there was a need to address how financial markets accessed SMEs and how SMEs accessed finance. Crowdfunding was leading the way. In other countries, the biggest problem was access to bank accounts in the UK. There was a need for grow SME funding by exporting crowdfunding throughout the EU.

Lord Hamilton of Epsom agreed about crowdfunding. He said that the bottom-up approach was where you saw growth. He said that the EU should look to the UK, where unemployment had fallen and SMEs were growing. That was where growth came from. The question needed to be asked why French entrepreneurs came to the UK. The problem was that the issue was being looked at from the top down.

Graham Bishop, Consultant on European Integration, welcomed the Green Paper, although he was concerned at the short time available to respond. He had been involved in the Financial Services Action Plan and the Giovannini process, so this was the third time that these issues were being discussed. It was disturbing that issues previously raised as barriers like securities law and tax mechanisms were still a problem. He welcomed Jonathan Faull's suggestion that Country-Specific Recommendations could be used to address these issues country-by-country. There was a need to name and shame. Capital Markets Union was of huge benefit to the UK, in particular given it had a current account deficit of £100 billion.

Lord Davies of Stamford made five observations. First, with regard to the points made about risk-sharing across Member States, he said that this was an attractive idea in a currency union and in the eurozone in particular. It was an automatic stability mechanism, although figures were needed on the extent to which it was happening. It was more problematic across currency areas. Second, he said that it was problematic to weaken the Prospectus Directive because of the effect on consumer confidence. IFRS provided a comfort to investors and also in terms of corporate governance best practice of better disclosure and control of directors. Third, he pointed out that the US had venture capital and private placements. Fourth, on covered bonds, he said that if this referred to secured bonds, then there was a direct comparison with the reliance by most UK companies on debentures in the first half of the twentieth century. He thought that such a mechanism could be promoted again. Fifth, on supervision, he said it was to be expected that the Bank of England and HM Treasury would oppose a pan-EU model. Yet it was a general rule that a set of unified rules without common enforcement meant that you did not have a common regime. This created the risk of regulatory arbitrage.

Andrew Van der Lem, Managing Director, Communications and Information, British Business Bank, said that there was a need to take action quickly. Capital Markets Union was about SMEs, but they were a difficult asset class. There was not much data and much of it was held by banks, and it was not easy for investors to access this information. There was also a sense of inertia among financial service providers and small businesses themselves. The US model and regulation was worth looking at—he drew attention to the Small Business Administration in the US, which focused on the SME market and intervention in the non-bank space. This played a part in diversifying the market, by investing in debt funds, then lending on to small business, creating a market and a track record whereby institutional investors could be attracted. In the UK, the British Business Bank did this in relation to crowdfunding and venture capital. When people thought about high quality securitisation and private placement, it was important to bear in mind the role of the British Business Bank, the European Investment Bank and the European Investment Fund to kick-start such activity. However he stressed that their role would be a short-term one in creating a track record in the purchase of assets, rather than a long-term function.

Lachlan Burn, Partner, Linklaters, said that the Green Paper was a hodgepodge of disparate ideas. There was a need for funding of infrastructure projects and SME financing. However there was a need to treat such elements as different concepts requiring different treatment. He found the leaked Green Paper to be lacking in detail on why Capital Markets Union was necessary, and on the logic behind it. While there was reference to growth and jobs, there was less detail on how this could be achieved by strengthening capital markets. He said that reducing the cost of capital could be a way to help companies create more jobs. But other possible (and important) objectives were missing—for example, the need to create investment opportunities for those saving for their old age provision. Retired people needed predictability of income and income producing investments (such as corporate bonds) could provide that, thus helping to wean individuals off state welfare that was becoming increasingly unaffordable. It was important to identify why one was doing something before one started doing it. His heart sank at the proposal to reform the Prospectus Directive. However the key point was that made by Lord Hill, about the need to join up the dots. There was a need to protect consumers without creating an onerous regime deterring issuers from entering the market. A market with no supply was not a market. The disclosure requirements in the Prospectus Directive, the intermediation provisions in MiFID and other provisions (such as regulatory product intervention) on what could be sold and what could not were examples of the regulatory tools available. They were in different directives or regulations but it was important to think of them together. And it was also important to take all available evidence relating to the effectiveness of the different tools into account. For example, in relation to the Prospectus Directive, there was copious evidence that retail investors did not read long documents, not more than three pages—so why did the Prospectus Directive require such extensive retail prospectuses when offering denominations for under £100,000? However this model was persisted with. There was a need to think about how to change this for the better.

Lord Davies of Stamford said that although retail investors may not read them, brokers and advisors would.

Michael Dakin, Partner, Clifford Chance, pointed to the US requirements for disclosure and quality of information. He said that sunlight was the greatest disinfectant. It was important that information was provided in bite-size chunks. Dumbing down the disclosure requirements was not a good idea. He also said that there needed to be uniformity. He said that SMEs varied massively in size and turnover. The problem with SME financing was the amount of effort needed to understand a particular business and make a meaningful investment decision. It was difficult to get banks interested in enterprises below £50 million. There was a need for a bifurcated approach and incentives for banks rather than individuals. He agreed that the US Small Business Administration was a good model, partly because it took the first loss and spread risk. There was a need to look at co-ordination across jurisdictions, both in the EU but also in the US and Asia. Disclosure standards in the US (the 144A rule) meant that the Prospectus Directive became irrelevant.

Joanna Cound, Managing Director, BlackRock, said that it was important to bring the top-down and bottom-up approaches together. The more investor-centric Capital Markets Union was, that is to say the more regulation responded to the needs of the asset owner, such as the retail client, the pension fund or insurance company, the more successful it would be and the more capital it would attract. Transparency, disclosure and certainty were important for asset owners, not just at the point of sale but all the way through the process. It was key to make sure that the capital of assets owners was treated fairly while invested in capital markets right through to the recovery and resolution of CCPs. She said that on the retail side, the majority of BlackRock's clients were in cash and property, not in capital markets. The question was how to create confidence for them to invest in capital markets. Digital developments and technology had created an opportunity and would fundamentally alter distribution channels. She said technology and a digital passport for investors could enable advice and guidance to be given to more people, not just to the wealthy. Increased advice and guidance meant that confidence increased. She added that the Commission should look at liquidity in secondary corporate bond markets. Banks did not have the inventory to make markets on the same scale as before which meant that execution risk had passed to end investors. They would bear the impact of increased bid-offer spreads in the future. There was a need to increase liquidity in the secondary bond markets to minimise this impact. The new issuance market had been extremely active but had fragmented liquidity in the secondary market as so many fixed income securities existed per company, making the buying and selling of individual securities difficult. Ms Cound agreed about the need to free up bank balance sheets. Bank loan funds could help here as well as securitisation. Bank loans were important in the US yet little known in Europe. In the EU, increasingly the only way for asset owners such as insurance companies to achieve the yield necessary to meet their liabilities was in the high yield and emerging markets. Quantitative Easing was intensifying the difficulty, forcing insurance companies out of low yielding and into higher yielding debt. Bank loans would diversify the investment opportunities open to investors. There was investment in private placement markets but on a small scale in Europe. Private debt markets was the area where the European market was most fragmented with relatively small pools of assets in each country. Generally, non-bank finance did not enjoy a level playing field with banks in relation to access for data, withholding tax and treatment in insolvency. She advocated a 29th regime asset passport model to allow cross-border investment in private debt markets on more equal terms.

Katie Kelly, Director, Market Practice and Regulatory Policy, International Capital Market Association, said that Capital Markets Union should not necessarily be about new legislation. Rather she stressed the importance of deregulation. More could be done to incentivise investment in relation to private placements, for instance reviewing the capital charges in Solvency II provisions. With regards to infrastructure, some regulatory issues could be reviewed in order to assuage investors' concerns, such as those involving revenue risks, retrospective change to tariffs, and also Solvency II.

Thomas Donegan, Partner, Shearman and Sterling, said that the emphasis on disclosure in relation to the Prospectus Directive was perhaps not the right focus. Currently the Prospectus Directive worked by getting the home country to approve a prospectus, and then a passport could be requested allowing access to investors elsewhere in Europe. There was currently a passport system but it was little used in practice because of the need for translation into different languages and concerns of banks and auditors about liability. This led to a reluctance to apply for passports. One solution was to ease the translation requirements; another would be to make passporting and translation mandatory. He was not sure that requiring either more or less disclosure was the answer to improving cross-border capital markets access.

Richard Metcalfe, Director of Regulatory Affairs, Investment Association, said that the Single Market was stronger on the wholesale side than on the retail side. It was important to explore digital opportunities. It was difficult to achieve retail distribution across the EU because of the need to look closely at investor protection. There was currently a patchwork in terms of how investor protection worked. The high level principles were there but when comparing the detail of the Insurance Mediation Directive and MiFID there were some important changes that could tilt the balance towards one product or another, which could happen to be widely distributed in one Member State rather than another. There was a good foundation in the form of UCITS and potentially in ELTIFs, though the 'asset passport' could have enhanced the latter. The Prospectus Directive review was welcome, so that more information could be supplied to institutional investors at a quicker speed in this process. Securities law legislation was not a visible barrier, but was an important issue that risked undermining Capital Markets Union. Regarding the tax regime, he noted that withholding tax on dividend payments cross-border were not being properly enforced. It also was important not to overdo systemic regulation.

Bernardita Jimenez, Director, Bank of Tokyo Mitsubishi, said that Capital Markets Union created many opportunities for the banking industry. Finance was a flow not a collection of silos. A diversification of funding called for integration of financial markets, rather than silos. Maturity transformation was important. There was a need to channel funds towards long-term infrastructure projects or transform long-term savings into short-term financing. Banks had a speciality here. In terms of opening Europe to foreign investment/funding, it was important that such funding came from a regulated industry, such as the banking industry, where, over the last six years, regulators had been working on strengthening and harmonising regulatory requirements. However she feared that the while the post-crisis regulatory framework had been aimed at closing areas of risk in the financial industry, the new proposals were liberalising some of these areas, and in the long run, if regulators were not prudent, it could give rise to procyclicality. One needed to be cautious in relation to these reforms about opening the door to a new crisis.

William Wright, Managing Director, New Financial drew attention to three issues. First, the scale of the opportunity. He said that the venture capital market would have raised $200 billion more, the IPO market would have raised $100 billion more, and the high yield bond market would have gained $700 billion more, totalling $1 trillion over 5 years, if EU capital markets had been as deep as in the US. Second, the scale of dis-union. He said that the comparison with the US only went so far. There were massive differences between Member States in terms of the size of the stock market relative to GDP. It was 130% in the UK, twice the EU average of 64%. There was a long tail of newer Member States whose stock markets were only 10-20% of GDP, or even less. There was a need to develop standards, protocols and systems for Member States with under-developed capital markets. Third, the question of demand, which was the elephant in the room. There was a lack of long-term pools of capital. There was too much emphasis on the process, on market structures and market participants. Yet pension assets were one-third the size of those in the US relative to GDP, or one-fifth if one took out the UK and the Netherlands. Capital Markets Union would not be effective without addressing these issues.

Marte Borhaug, Senior Policy Adviser, Financial Services, CBI, said that it was important to focus on who one was trying to help with Capital Markets Union and ensure one was not just talking about SMEs in terms of their size but whether they were growing and had the ambition to grow. A capital market needed to focus on companies with the ambition to grow. There were things that could be done to improve the market, but companies themselves also needed to take the initiative to look for alternative sources of finance. There was a need for an adjustment in the ambition of Capital Markets Union, keeping it focused on what it could deliver in the short term for growing companies. She also spoke about the division between the Capital Markets Union initiative and looking back at past regulatory reform. She was pleased to hear that the Commission would be looking at the cumulative effect of the new regulatory framework. A pro-growth voice was needed in consideration of proposals still under negotiation, such as those on Money Market Funds. She was concerned that the Commission was not listening to views on how rules on MMFs might impact the companies who use them. She too stressed the need to join the dots.

Graham Bishop said that on the question of procyclicality, there was now an asset/liability model for banks, insurance companies and certain pension funds. Banks now needed to keep their liabilities in balance should their assets become problematic. The development of Capital Markets Union should aim to create more holdings by individuals not subject to these rules, which would decrease procyclicality caused by asset-backed chains from banks. On securitisation, half was retained by banks rather than sold, so as to be 'repo'-ed to the ECB. This was one of the problems flowing from the monetary policy situation. Moreover, if the best assets of banks were securitised, then correspondingly banks were left holding the worst assets.

Lord Harrison asked the panellists to respond to the discussion.

Charles Roxburgh said that the Capital Markets Union agenda was exciting. The consensus view was that it was a force for growth. HM Treasury would seek to play an active role, subject to the view of ministers. He stressed that Capital Markets Union should be viewed as a long journey. It would not be possible to complete it in two or three years.

Jonathan Faull agreed that it had been a helpful discussion. He said that the need to achieve balance in terms of the information required of SMEs was a perennial dilemma, which meant that it had been difficult to get the Prospectus Directive exactly right. There was a need for comparable credit information, but there was a question as to how much detail was required and how much comparability was needed given the limits of retail investors. On the other hand brokers might need more information. In addition, the US had very detailed data requests and they stressed that EU requirements needed to dovetail with international standards. The challenge was to keep investors interested without imposing excessive burdens on SMEs.

Barnabas Reynolds agreed with HM Treasury and the Bank of England that responsibility for oversight and resolution of CCPs should lie with Member States when they were providing liquidity and would be responsible in the event of a failure. On Capital Markets Union more generally, he said that people were holding back because of uncertainty over regulatory liability and lawsuits. There was no common approach across courts and regulators, and fines were crippling. The issue would rear its significant head in relation to Capital Markets Union. He cited the model of shipping in the sixteenth and seventeenth centuries, when the liability of a ship owner was limited to the value of the ship in order to encourage people to risk the perils of the sea. It was not in the interests of the market for regulators to create limitation of liability by keeping on setting up new shell companies. There were questions that needed to be addressed regarding the fair level of liability for intermediaries and what would happen if things went wrong.

David Doyle said that he remained optimistic about Capital Markets Union. There was a need for a better balance between bank-based intermediation and capital market-based intermediation. He reiterated that this was a work-in-progress and was a long-term project. He said that the feasibility of introducing an EU private placement regime needed further work, but acknowledged that it had been made easier in certain mainland Member States. He cautioned, however, that onerous reporting requirements often accompanied such initiatives, with the system becoming bogged down in very complex, tax-driven reporting systems. He said that equity-based crowdfunding was dominated by the UK compared to the rest of Europe, which alongside other online alternative finance initiatives, like peer-to-peer lending, had raised some €2.34 billion during 2014. An obstacle to cultivating an active EU lending market was the need for new non-bank entrants, which did not take deposits, to obtain a banking licence. This needed to be reviewed. On the Prospectus Directive, he said that there was need for further streamlining. He said that lessons could be learnt from PRIIPs, which set out information in a four page standardised and digestible format. A big issue in terms of consumer protection was the growing level of financial illiteracy among EU citizens. Unless such vehicles as the simplified Prospectus Directive and the standardised PRIIPs key information document, using accessible financial language, were used, people could risk making wrong investment decisions.

Hugo Dixon said that it was possible to secure long-term investment with short-term finance so long as there were liquid secondary markets. There was a question as to whether secondary markets were being gummed up. One way they could be gummed up was by the proposed Financial Transaction Tax. Although the participants couldn't agree, they needed something to get them off the hook, such as a pan-EU bank levy. He also stressed the need to level the playing field between debt and equity by removing the tax bias towards debt, which was tax deductible. The Commission could not impose this on Member States but they could encourage Member States to remove or reduce the tax bias towards debt. If Member States did it together, there would be safety in numbers.

Sharon Bowles said that an alternative to the Financial Transaction Tax was a Financial Leverage Tax, where there would be no tax relief once a financial institution was leveraged above a certain level. She said that currently instability was being subsidised through leverage. This could be a soft buffer before a regulatory hard buffer. She said that banks had a role to play in growing the markets, and Lord Hill had said this in one of his appointment hearings. SMEs were a good source of jobs but were not so good at growing from medium to large companies in the UK. There was a need for them to scale up and she referenced the recent report by Sherry Coutou. This applied across the EU. She liked the idea of Country-Specific Recommendations being used, for instance in relation to tax and debt/equity. She said that the ECON Committee had announced how many CSRs were followed by Member States, and it was not very many. There was a role for the European Parliament to name and shame, in the hope that the Council would do something. On risk-sharing, she said that the currency problem was in retail but not for institutional investors who wanted exposure to different currencies. This however would be a retail disadvantage when there was a cross-currency issue.

Sharon Bowles added that there was a big culture problem. In the UK, one would not put a 'tried and failed' business on one's CV, whereas in the US one would. There needed to be an acceptance that one could fail. On the other hand it was not possible to create a no risk environment. The reforms that had been introduced had not made the taxpayer totally safe but rather had shifted risk from one cohort to another. If a bank failed, it was important that assets were spread widely. She said that there had been discussions about the key information document and the liability implications. In terms of the Prospectus Directive, the European Parliament tried hard not to create something with too many disclosure requirements that amounted to saying the sun might not shine. A list of long disclaimers was not the way to go. She liked the idea of an asset passport regime and encouraged Jonathan Faull to take this away and introduce it as soon as possible, making it retrospective to ELTIFs. The idea of a sub-class of infrastructure with preferential treatment and a passport regime applied could be the beginning of the 29th regime. There was also a need to use technology to simplify reporting, but she feared that the UK would complain about EU templates as it had with PRIIPs. There was a need to bite the bullet.

On cumulative Impact Assessments, Sharon Bowles said that the problem was that not everything was finished. Instead a policy impact trend could be undertaken, assessing what the big legislative files had done in a simple positive or negative sense in terms of their impact on risk, concentration, liquidity, choice and so on. This could lead one to a conclusion about what needed to be fixed. She said that each piece of legislation had been subject to hard negotiations. There was a risk that if one part of a package was pulled, the rest of the framework could unravel.

Lord Harrison thanked all participants for their attendance and for expressing their views, and closed the seminar.